SUPREME COURT

OF THE UNITED STATES.

HENRY ARNOLD RICHARDSON, as Trustee in Bankruptcy of J. Francis Brown, *Petitioner,* *against* JOHN M. SHAW and ALEXANDER DAVIDSON, *Respondents.*	Petitioner's Brief.

This cause comes here by writ of certiorari to the Circuit Court of Appeals for the Second Circuit. It was begun by the petitioner as trustee in bankruptcy of J. Francis Brown in the District Court for the Southern District of New York. Upon a judgment entered against him on a verdict directed in defendants' favor, he sued out a writ of error, and on an affirmance thereof filed a petition here for a review of the record.

The action was brought to recover a preference.

A Resumé of the Salient Facts.

The bankrupt, a stock broker in Boston; respondents, a firm in New York, customers of Brown on speculative account for purchase and sale of stocks on margin managed by their Boston agent; all transactions begun, continued and ended in Massachusetts; carried on for several months, February to June, 1903; respondents' margin started with $500; after various payments to and fro account showed considerable gains; Brown pledged to various bankers the securities, deposited with him and bought by him on their account *on general loans;* this *pursuant to agreement;* became insolvent; on June 24th re-

spondents' agent on learning of the insolvency demanded cash payment of $5,000 and received it; next day demanded the securities; obtained them the day after in the following way: securities assembled in hands of Brown, Riley & Co.; insolvent's "margin on loans" with latter about $10,000; accounting between insolvent and respondents showed value of stocks to be delivered to them $45,583.75, amount to be paid by them $34,919.62 (increased by the $5,000); insolvent turned over to Brown, Riley & Co., his check for $1,200, and a note of a debtor for $5,000, thereby increasing the "margin" to his credit with them above $10,664.13, of which he made in effect an equitable assignment to the respondents; thereupon, defendants' banker gave Brown, Riley & Co. a check for the $34,919.62, and received from them the securities; insolvent made assignment next day, was adjudicated bankrupt within four months, and petitioner was elected trustee.

The respondents conceded at the trial, "that among the creditors of said Brown there was on said day a number of general creditors upon transactions in purchase and sale of stocks by said Brown as broker *similar to the transactions in purchase and sale of stocks by said Brown as broker for the defendants.*"

The foregoing resumé is condensed from the portions of the record, which will now be given with references to the pages.

The Facts

(More Fully Stated).

1st. In June, 1903, J. Francis Brown, a stock broker in Boston, Mass., failed, and in the following October was duly adjudicated a bankrupt, and the plaintiff was thereafter duly elected as trustee in bankruptcy, executed the required bond, and entered on the discharge of his duties.

Pages 4, 8.

2nd. In the preceding February, defendants had opened "a speculative account" with him for the purchase and sale by him as broker on their account of various securities, the transactions being conducted in Boston through their local agent, and the account carried in his name, "Royal B. Young, attorney."

Pages 10-11.

3rd. The method of business was as follows:

A debit and credit account was opened February 10th, defendants deposited with Brown $500 as margin, which was credited to them on the account, and Brown purchased for them certain securities at a cost of $3,987.50, which was charged to them on the account (p. 29).

Thereafter and until the account was closed on June 26th, defendants from time to time paid to Brown various other moneys as margins, which were credited to them, and also transferred to him various securities as margin in place of cash (pp. 11, 17-18, 41).

Brown bought various securities for them, the cost of which was charged to them; paid them various sums of money, which were also charged to them; and sold for them various securities, the proceeds of which were credited to them (Ex. No. 4, pp. 29-34, being the whole account).

The stocks were figured at the market price every day and statements rendered to Young (p. 11).

Defendants kept a "liberal margin" at times rising to 23½ per cent. (pp. 10-11, 18-19), and had the right by custom to reduce the margin to 10 per cent. by demanding payments on account (pp. 18-19).

It was part of the agreement between the parties that "all securities carried in this account or deposited to secure the same" might be carried in Brown's "general loans" (pp. 11, 27-28, 29, 35).

Such was the custom of the Boston market (p. 11) and the law of Massachusetts (*infra*).

4th. Brown pledged on his general loans all the securities thus carried by, or deposited with, him on defendants' account, and Young was informed of the fact.

Pages 11-12.

5th. Most of them were pledged with Brown, Riley & Co., the remainder with two banks, who however transferred them to Brown, Riley & Co., so that the latter on the day the account was closed June 26th, held all of such securities, together with various others as collateral on general loans to Brown, his margin on the whole being about $10,000.

Pages 11-12, 15, 22.

The word "margin" seems to be used in respect of loans in the same sense as the word "equity" in speaking

of the interest of an owner of real estate encumbered by a mortgage.

6th. On June 25th Brown was and had been for the two preceding months insolvent within the meaning of the Bankrupt Law, and among his creditors *there were a number of general creditors* upon transactions in purchase and sale of stocks by him as broker *similar to the transactions with defendants.*

Page 8.

7th. Young's brother was Brown's manager, and through him Young learned of Brown's insolvency and set to work to save defendants from loss.

Pages 8, 9, 12.

8th. Young first demanded payment of $5,000 in cash, and on getting it June 24th, he, then, on the following day, "Hooker Day," demanded a final settlement on the ground as stated by him that Brown was "busted," and threatened attachment. Brown was at the time ill and the business was managed by his clerk, Lawrence B. Fletcher. The next day, June 26th, Young made up a statement of the account for Fletcher to "check over" and "see if it agreed."

Pages 12-13.
Ex. No. 3, p. 28.

9th. Upon this accounting it was found as follows:

Amount of securities to credit of defendants	$45,583.75
Charges to credit of the insolvent	34,919.62
Balance	$10,664.13

Page 28.

(This balance is called "margin" in the account, and had been reduced by the payment by Brown of $5,000 two days before.)

The securities mentioned in this account were the ones delivered upon the settlement (none of the specific certificates being any to which defendants ever had any title, *infra*). For convenience, they are here arranged alphabetically, with a statement collated from Exhibits Nos. 6 and 10, showing what had been bought for, and what deposited by, defendants, and the history of the specific certificates:

Ex. No. 3.

(arranged alphabetically)

				Ex. No.6.	Ex. No.19.
I. STOCKS					
Name	No. of	at	value		
Adventure	20	7	$ 140.		collat
Allowez	10	6	60.		bought
Amalg.	360	54¾	19710.	Placed*	collat
Amer. Tel.	24	141	3384.	"	bought
Amer. Wool pr.	10	76	760.	"	collat
Araslon (misprint see Old Dom.)					
Copper Range	20	54	1080.		bought
Dom. Iron	65	17½	1137.50	15 "	"
Elm River	50	3	150.		"
Mass. Elec. Com.	50	26	1300.		"
N. Y. N. H. & H Ry.	3	196	588.		collat
Old Dom.	10	13	130.		bought
Sug Pfd.	5	118	590.		collat
" Com.	7	119	833.	"	"
Shannon Copper	1670	11½	12305.		bought
Trinity Copper	15	5¾	86.25	"	"
U. S. Mine	50	22	1100.		"
" " Steel Com.	15	20	450.	"	collat
Winona	20	9	180.		bought
II. BONDS.					
Shannon 7s	2	80	1600.		collat
			$45583.75		
			34919.62		
		Margin,	$10664.13		

*"Placed" means that certificates for a larger number of shares were handed to Mr. Gale, who after transfer returned certificates for the excess (page 21).

There are misprints of words in Ex. No. 3, and of figures in the other two, but nothing misleading.

Two lots of Shannon stock, one for 50, the other for 100 shares in the original of Ex. No. 6 have been left out of it as printed, making 1070 of Shannon shares in all. The figures "3100 Shannon" in same exhibit should be 100 Shannon.

The letters Acp. in Ex. 10, stand for Amalg. cpf. 3100 Acp. should be 100 Acp.

The last two lines of figures in Ex. No. 10, should represent 10 Acp., making 360 Amalg. in all.

Ex. No. 10 is on one of Brown's blanks and the headings of the columns are printed and devoid of significance.

10th. The liquidation of this account was effected as follows:

The insolvent endorsed to Brown, Riley & Co. a note of $5,000 made by one of his debtors, and gave them his check for $1,200, thereby increasing his "margin" on his general loan, and agreed that $10,664.13 should be charged against it, and credited to defendants, and there-

upon through the Beacon Trust Co. the securities were delivered to defendants on receipt of a check to order of Brown, Riley & Co. for $34,919.62.

Pages 22, 15, 8.
Receipt of Gale, Ex. 6, page 38.
Check of Trust Co., Ex. 7, page 39.

Defendants thus obtained securities of the agreed value of $45,583.75

By payment by themselves,	$34,919.62
By claim of Brown orally assigned to them,	10,664.13
	$45,583.75

11th. None of the certificates of stock thus delivered to defendants were the identical certificates which they had delivered to Brown as margin.

Page 23.

Nor were any of the certificates bought for defendants the same as those delivered to Gale.

The two Shannon bonds were, however, the identical ones which Brown had received from them (p. 23).

12th. Brown made an assignment next day, June 27th.

Pages 22, 16.

13th. At the close of the plaintiff's case the defendants' counsel moved for a direction of the verdict in favor of the defendants and the plaintiff's counsel requested to go to the jury upon the issue of fact as to the knowledge by defendants through their agent Young of the insolvency of Brown.

Pages 23, 24.

14th. The learned Trial Justice ruled that the defendants were not creditors of the bankrupt, but debtors, and on paying their debt of $34,919.62, obtained the securities as their own property, and that the payment of the $5,000 was not of a debt, but as an advance, and directed a verdict for the defendants, to which plaintiff duly excepted.

Pages 23-26.

15th. The plaintiff proved the law of Massachusetts, by various cases which, under agreement, are to be referred to in the reports as if printed in full in the bill of exceptions.

Page 10.

The Assignment of Errors.

That the Court erred in directing a verdict for the defendants; and in not submitting to the jury the question of fact whether Royal B. Young, the agent of the defendants acting therein, had reasonable cause to believe that a preference was intended by the payment of June 24th; and by the transfer of June 26th.

Page 42.

Question Involved.

The exact point up for decision is, whether customers of an insolvent stock broker, who is carrying for their respective accounts on margin stocks, which with their consent he has pledged on general loans, are creditors within the meaning of the preferential section of the Bankrupt Law.

It cannot be gainsaid that the transaction at bar was in fact a preference of a *customer*. Was it in law a preference of a *creditor?*

POINTS.

I.

In the eye of the Bankrupt Law, the respondents were creditors of the insolvent, and his transfer to them of assets of his own, whereby they were enabled to redeem without loss to themselves the stocks which in carrying on their account he had pledged on general loans, constituted a preference over other customers as creditors in the same class.

1st. Plainly so, if the *lex loci* is to govern.

The contract was made and performed in Massachusetts, under whose law broker and customer are parties to an executory contract, whereby the broker is obligated to deliver to his customer on demand specified stocks at a price certain.

Wood *v.* Hayes, 15 Gray 375;
Covell *v.* Loud, 135 Mass. 41;
Chase *v.* Boston, 180 Mass. 458.

If the broker does not comply, the customer has a claim provable in insolvency.

Lothrop *v.* Reed, 13 Allen 294.

And if an insolvent broker uses his own assets to carry out such a contract, it is a preference under the insolvent law.

Weston v. Jordan, 168 Mass. 401.

The differentiation which the learned Trial Judge attempted to make between that case and this (Record, p. 25) is fallacious.

True, the broker there "had parted with the control of the shares" (whether by sale or pledge does not appear), and had at first refused to comply with the demand, and that the Court said it was this refusal which gave the cause of action, and so his change of mind and use of his assets in buying other shares and complying with the demand was a preference. But what difference is there in principle between an insolvent broker complying at once, and after a previous refusal? The point is that the customer has the right to make a demand, and the Bankrupt Law defines a creditor to be "any one who owns a demand or claim provable in bankruptcy."

The Act, §1 (9).

And the Federal Courts in the First Circuit have held that a claim so arising under a Massachusetts contract is provable in bankruptcy without the formality of a useless demand.

In re Swift, 105 Fed. Rep. 493;
Affirmed, 112 Id. 319;
Approved by Eighth Circ. Crt. of App. in Watson *v.* Merrill, 136 Fed Rep. at p. 364.

True, that in *Swift's* case, Lowell, *J.*, in commenting on *Weston* v. *Jordan*, takes that case to hold that under a Massachusetts contract no right of action accrues to the customer until after demand, and holds that bankruptcy supersedes its necessity. Why not insolvency also? The right to make a demand, and the necessity for making it under a given state of facts, are two different things.

It may be noted that in *Weston* v. *Jordan*, the Court says (p. 404), that it had been asked to reconsider its former decisions and put the law of Massachusetts in

harmony with that of New York, and declines, saying the facts of the case do not call for such reconsideration. But in *Chase* v. *Boston,* the Court did reconsider and did reaffirm its doctrine, saying per Holmes , *C. J.,* (p. 459), " We see no sufficient reason for departing from what has been understood to be the law of Massachusetts ever since the time of Chief Justice Shaw." He also says (p. 460), " The English doctrine seems to be the same as that of this Commonwealth, so that we are not left quite alone in a desert of logic, *Bentinck* v. *London Joint Stock Bank* (1893) 2 Ch. 120, 140, 141."

In urging that the respondents are to be regarded as creditors under the law of Massachusetts, we are not impinging on the doctrine of *Swift* v. *Tyson,* 16 Pet. I. (U. S. Rev. Stat. §721). This is not a case of construction of a contract, so much as it is the ascertainment of a status. The Bankrupt Law forbids an insolvent to prefer a creditor. If under the law of Massachusetts customers of stock brokers have the status of creditors, are they to be held to retain it for the purpose of proving claims, and to lose it for the purpose of obtaining preferences?

The respondents had a right on June 24 to demand from the insolvent on payment by them to him of $29,919.62 the delivery of securities, which along with others pursuant to law and agreement he had pledged to a banker on general loan, the value of the securities demanded was $45,583.75, and his margin of loan on all the securities so pledged was only about $10,000; they could not effect redemption from the banker with $29,919.62; they demanded from the insolvent $5,000 in cash; he complied, and on demand of the securities he strengthened his margin of loan with his banker by a transfer to the latter of additional assets(cash and note); respondents with the $5,000 so paid and an additional $29,919.62, making $34,919.62, redeemed the securities, *paying the money to the banker directly;* and the insolvent's margin of loan was wiped out to the extent of $10,664.13. It is a clear case of a transfer in cash of $5,000 and a transfer in equity of a margin of $10,664.13 in the banker's hands, and preventing an equal distribution of those assets among other customers in the same class.

The demand of the $5,000 one day, and of the stocks the next, both in pursuance of respondent's

plan to save themselves, should be treated as parts of a continuous transaction, wherein they got the stocks the day after.

Thus it is a plain case of preference of one Massachusetts creditor over others. If the Massachusetts law may be invoked to free a party from the same section of the Bankrupt Law (*Humphrey* v. *Tatman*, 198 U. S. 91), why may it not be invoked to bind him? Hence we claim that there was a preference by virtue of the *lex loci*.

2nd. Equally so, under the *lex fori*.

The law of New York can only be said to be the law of the forum, because the learned Circuit Court of Appeals in the Second Circuit disregarded the decision of the First Circuit in *Swift's* case, and applied, or rather supposed that it applied, the law of New York.

But, even under the law of New York, the respondents should be considered as creditors of the insolvent broker. In that State broker and customer are parties to an executed contract, whereby the latter becomes the owner of specified stocks, and if he has availed himself of the broker's credit to aid in their purchase, he is deemed to have pledged the certificates to the broker for the amount of the latter's advances.

Markham *v.* Jaudon, 41 N. Y. 235;
Stewart *v.* Drake, 46 N. Y. 449;
Baker *v.* Drake, 53 N. Y. 211;
Stenton *v.* Jerome, 54 N. Y. 480;
Baker *v.* Drake, 66 N. Y. 518;
Gruman *v.* Smith, 81 N. Y. 25;
Capron *v.* Thompson, 86 N. Y. 418;
Cassell *v.* Putnam, 120 N. Y. 154;
Gillet *v.* Whiting, 120 N. Y. 402;
Gillet *v.* Whiting, 141 N. Y. 71;
Minor *v.* Beveridge, 141 N. Y. 399;
Hurd *v.* Taylor, 181 N. Y. 231;
Content *v.* Banner, 184 N. Y. 121;
Leo *v.* McCormack, 186 N. Y. 330.

And even though the broker is not bound to keep on hand the identical certificates,

Taussig *v.* Hart, 58 N. Y. 425,

yet if he puts it out of his power, by sale or rehypothecation on general loan, to deliver the identical or similar certificates, he is guilty of conversion.

Lawrence *v.* Maxwell, 53 N. Y. 19.

How trover can be predicated of a chose in action, separate from the physical instrument which evidences it, seems not to have received due attention. I may convert my customer's certificate of stock by an unlawful sale or pledge or destruction, and make myself liable for the resulting damages, to wit, its market value as a chose in action; and I may make satisfaction by giving him another certificate instead. But if words are coins for use in the exchange of thoughts, how can I be guilty of a *conversion* of a cause of action?

Moreover, in respect of tangible things, which if law terms are to retain fixed values, are the only kinds of personal property that can be converted, how can one be guilty of conversion of a thing unless he has it in his possession? It may be that a pawnbroker, who has wrongfully re-pawned my watch, cannot plead his own wrong for failure to deliver it on my tender and demand. In fact, he converted it to his own use when he pawned it for his own benefit. How if he pawns it with my consent? It is then out of his possession lawfully. How can his failure to regain possession be called a conversion? If I go into equity, and am met by a number of other persons, whose watches were pawned on the same loan with their consent, our entangled rights can only be disentangled and adjudged according to the maxim, equality is equity. There does not seem to be any case in the New York reports where the effect of the customer's consent to a rehypothecation came up for decision.

That State's doctrine has entailed much inconsistency (*infra*), but is still clung to by our New York Courts as a theory, long after our brokers have gotten round it in fact by an express or implied stipulation that they may rehypothecate on general loan all securities carried by them, thus rendering, as we venture to think, the difference between the New York and Massachusetts views academic, so far at least as concerns the case at bar.

A *re*hypothecation (using New York phraseology) is rightful or wrongful. It is not necessary to consider a specific repledge, limited to the exact amount which the customer owes the broker, for in such case the broker does not have to make up any deficiency, the stock can be ear-marked, and the customer can get it from the pledgee on proving property and paying to him the amount of his own debt. There was no such specific repledge in the

case at bar. Nor are such ever made. No stock broker could do business if he repledged specific certificates on specific loans representing the amount of specific advances to specific customers. What he does is to pledge a batch of certificates on general loans and pay for them out of the proceeds and his customers' margins.

Now, whether such rehypothecation, still using the New York phraseology, be rightful or wrongful, the broker necessarily comes under an obligation to his customer to protect the latter from loss. To the amount, which his customer must tender to him in order to redeem the stocks as between them, the broker must add from his own assets such further sum as may be necessary to redeem them as between him and his pledgee. That obligation requires him to be regarded as a debtor within the meaning of Section 60 of the Bankrupt Law. Granted that the customer owns the stock, yet for the purposes of the act he must be deemed to own a demand, to wit, that the stock be cleared from a lien, which is not of his creation. Under the Bankrupt Law it is immaterial whether that lien was, or was not, created by his consent.

If such a rehypothecation on general loan is wrongful, the customer has a provable claim in bankruptcy.

Crawford v. *Burke,* 195 U. S. 176.

If rightful, it must all the more be provable.

Full of anomalies and inconsistencies as the stock law of New York is conceded to be, it has been reserved for a Federal Court, though untrammeled by that law, to make the most inconsistent application of it. Its logic is: the ownership of stocks carried on margin for speculation is in the customer, who is a debtor to the broker for the latter's advances beyond the margin; their relation is that of pledgor and pledgee; the customer, who demands his stock from an insolvent broker and gets it, simply regains possession of his own on paying his own debt, and such a transaction is not within the preferential section; true, if the broker wrongfully rehypothecates the stock, and is thereby guilty of a conversion, the customer has a provable claim in bankruptcy, and if the broker being insolvent transfers any of his assets to that customer, directly in satisfaction of such a claim, or indirectly by aiding the customer to redeem the securities from the second pledgee, it would be a preference, for the customer's claim for conversion puts him in the cred-

itor class as was decided in *Crawford* v. *Burke;* but we hold that if the rehypothecation be rightful, any contractual obligation of the broker to do the same thing does not have the same effect of turning a debtor into a creditor.

The answer to which is—if it needs one—that when various stocks of various customers are with their consent pledged by their common broker on general loan, no one customer can earmark in the hands of the general pledgee any particular stocks as his; being a stranger to the pledgee, he has no right to demand possession of a particular block of stocks on tender of a sum which he says he owes his broker; he has no claim for conversion against his broker; having neither possession of the stocks, nor a right of possession, he merely has a chose in action on tender of his own debt, a right to go into a Court of Equity, and on joining all parties in interest, pledgee, broker and all customers in like case, ask that the securities be marshalled, and the liens on them ascertained, the general lien of the pledgee on all, and the specific lien of the broker on each. That chose in action in favor of each of such customers is a provable claim in bankruptcy, for it is susceptible of liquidation in dollars and cents.

Thus, even if the law of New York be regarded as presenting a correct, though somewhat ragged, theory of the relation between broker and customer in respect of a speculative account in stocks carried on margin, the status of a customer, whose stocks with his consent have been rehypothecated by an insolvent broker, is that of a creditor rather than debtor.

3d. The true construction of the Bankrupt law, apart from any local law, requires the respondents and all customers in like case, as shown in the third admission (Record, p. 8), to be regarded as creditors in the same class.

> As the Courts below held that customers are debtors, not creditors, we do not seek to torture the use of the word creditor in this admission as a concession on the law point. All that was meant was that there were other customers in the like case with respondents. They all constituted one class, each occupying similar relations upon similar transactions In devoting $15,664.13 of his assets to help one of them,

the insolvent injured the rest. The Court may rule that they are debtors, but they have a sad knowledge to the contrary.

(1) It is not conceivable that Congress intended that stock brokers should be granted the benefits of the act under §4, and not be subjected to its prohibitions under §60.

(2) It is not tolerable that brokers should be regarded here as creditors and there as debtors.

A customer who upon demand on an insolvent broker does not get his stocks is a creditor, says the First Circuit in *Swift's* case.

A customer who upon demand on an insolvent broker does get his stocks is a debtor, says the Second Circuit in this case.

(3) Customers, whose stocks are being carried on margin by a broker by means of general loans in the customary way, are his creditors not only within the spirit of Section Sixty of the Act, but within its letter according to the definition of the word creditor in Section One.

A creditor is "any one, *who owns a demand* or claim provable in bankruptcy" (9th definition). The word debt includes, "any debt, demand or claim provable in bankruptcy" (11th definition).

Such a customer has the right on tender of a certain sum of money to demand that the broker redeem his stock from the general pledge, and he has nothing else if they have been thus pledged with his consent. If that is not ownership of a demand, which is susceptible of liquidation in dollars and cents, and therefore provable in bankruptcy, what is it?

(4) It is a self-evident proposition that a broker, who in the usual course of business pledges to a banker on general loans to himself various stocks, which he is carrying for various customers on margin under contracts recognizing such a custom, thereby comes under a contractual obligation to each customer to protect each against loss by reason of such general loans, and in case of inability through insolvency to protect all becomes *eo instante*, if not before, a debtor to each, and may not use his assets to prefer one at the expense of the others.

(5) If not self-evident, it is susceptible of mathematical demonstration.

Each of 100 customers, desirous of opening a speculative account, asks a broker to buy 100 shares of a certain

stock; he does so, and pays for the 10,000 shares with $100,000 of margins from his customers, $100,000 of his own and $800,000 he borrowed from his banker, to whom he pledges all the stock as security for one general loan, with an understanding that he may redeem any block of 100 shares on paying an aliquot part of the loan, to wit, $8,000.

Under the decisions in New York, which pay no heed to the difference between purchases for investment, and for speculation, each block of 100 shares is deemed to be owned by a customer, who is deemed to have pledged it to the broker, and the pledge by the latter to the banker is deemed a re-hypothecation. We shall urge in another point that this is fiction, not fact, and that the pledge to the banker is the first and only pledge.

Later on the broker borrows another $100,000 on the whole lot, and must necessarily agree to pay $9,000 in order to redeem any block of 100 shares; he loses it "in the street," or the river; no customer is injured; he has lost his own money; each on paying him the balance due on the purchase of 100 shares can through him get 100 shares from the banker.

But the broker borrows from the banker $50,000 more, and agrees to pay him $9,500 in order to redeem any block of 100 shares; again he loses some of it in street or river; and thus becomes insolvent; he cannot carry out his obligations to all his customers to redeem the stock, so that each can get 100 shares on paying $9,000. What then?

Who is to bear the loss? Not the banker. He has loaned $950,000 in good faith to a person having the *jus disponendi*. He does not know any customer, and is under no obligation to give to a stranger any block of 100 shares, even on a tender of $9,500, much less on a tender of $9,000. Are the customers to bear the loss equally, or is there to be a scramble? How can the situation be worked out with justice to all? There is no way except by consent of all, by decree of a Court of Chancery with all parties before it, or by proceedings in bankruptcy where the parties are in theory all present, the absent if forgotten by the others being protected by law.

The learned Circuit Court of Appeals in this case holds that an insolvent broker may use up his assets

in aiding favored customers to get their stocks, and the other customers may be left to prove their claims. It is a corollary from such a ruling that a stock-broker's insolvency differs from all others, in that most traders' failures are due to a plethora of debits, while his must be ascribed to a plethora of assets!!!

Such a conclusion, so abhorrent to the principle that equality is equity, is itself a demonstration that there must be a flaw in the logic, by which it is reached. We submit that we put finger on the flaw, when we say, that whether such a situation be viewed with New York or Massachusetts spectacles, yet in the eye of the bankrupt law behind those spectacles, the broker who pledges his customers' stocks on general loans, must be deemed to be a debtor to each by virtue of an obligation to each to protect each from loss thereby by redeeming the stocks from the general pledge, on demand made; and if being insolvent he uses his assets to aid any one of them at the expense of the others in the redemption of a particular block of such stocks, it is a plain case of preference under section sixty of the act.

The learned Court regarded the situation as one which only concerned the broker and a single customer. It forgot that there were others, as it did *in re Berry*, 17 Am. Bk. Rep., 467, and as was done by the Bankruptcy Court in *Hutchinson* v. *LeRoy*, 8th Am. Bk. Rep., 20. Section 60 was passed to protect the Forgotten Man. In so far as the use by a trustee of a bankrupt's assets in the redemption of one customer's stocks is at the expense of other customers in like case, such use is a preference by the trustee at the instance of the firstcomer. The trustee may not so use the trust funds. How, then, can the insolvent? Does not the Bankrupt law make an insolvent a compulsory trustee for his creditors during four months prior to bankruptcy? Is it to be tolerated that as between two similarly placed customers, both demanding from an insolvent, fulfillment of his obligation to deliver to them certain stock on their paying a certain balance due, that the favored one is to be regarded as a debtor so that he may keep his preference, and the other as a creditor, so that he may prove his claim? Are rights to depend on luck rather than law? Is it not the right to make the demand, which fixes the status under the plain language of the definitions in the act?

For these reasons, we submit that a plain case of preference of a creditor was made out.

II.

If, however, the pledge on general loan by agreement is not a controlling factor in bringing this broker and his customer within Section 60, and an inquiry must be made as to the true theory of their relation in respect of this speculative stock account, it is submitted that the New York theory should not be adopted, for that it is based on an assumption which has no foundation in express agreement and is directly contrary to custom.

1st. Your Honorable Court has never spoken on this subject.

In the cases between broker and customer which have come here, one from Utah, two from Illinois, whose courts have followed New York rather than Massachusetts, there was no need for such an inquiry.

Crawford *v.* Burke (*supra*);
Clews *v.* Jamieson, 182 U. S. 461;
Gallagher *v.* Jones, 129 Id. 193.

In the latter case, at page 198, Bradley, *J.*, says:

> "A broker is but an agent, and is bound to follow the directions of his principal, or give notice that he declines the agency. In the absence of a special agreement to the contrary, it is the principal's judgment and not his that is to control in the purchase and sale of stocks."

This was spoken with reference to the facts in that particular case. At page 201, in speaking of a case where a *trust* relation exists between the parties, he adds, "a relation which would probably be *deemed to exist between a stockbroker and his client.*"

We have not found any other deliverances.

2nd. The learned Circuit Court of Appeals, admitting that the New York decisions were not binding upon it,

suggests (p. 47) that the consequences of a serious conflict of authority renders it inexpedient "to vex the financial center of the country" by a failure on its part to adhere to a rule which has been enforced there for nearly 40 years.

Upon this we venture some observations.

"Vexing the financial center of the country," a phrase of many meanings, has been on many lips of late.

It may be that in the opinion of the Court the conflict of authority, which has existed for many years between Massachusetts, backed up by England, and New York followed by Illinois and other States, is not a serious one. But that only goes to show that the Court, enveloped as it was by the local atmosphere, regarded the question as parochial, rather than national.

No question is ever settled until it is settled aright. Granting that the financial center of the country would be vexed by upholding the doctrine of Massachusetts, older by ten years, it will continue to be vexed, and lesser centers throughout the country also, by a continuance of the inconsistencies into which the courts of New York are perforce led in a struggle to preserve that theory in form, while eating out its heart by piecemeal.

3rd. By an interesting coincidence, each theory has at this moment an exponent on your Honors' bench, coming here from the Court of last resort in his State, and having taken part in decisions which expound that State's doctrine.

Gillet *v.* Whiting, 141 N. Y. 71;
Chase *v.* Boston, 180 Mass. 458.

Into a battle between giants a pigmy should not have the temerity to thrust himself. It is our humble task, if the metaphor is permissible, merely to toss the apple of discord.

4th. We may, however, quote from learned Judges and text-writers on the subject of this conflict of authorities.

"No doubt, whichever view be taken, there will be some anomalies, and no doubt it is possible to read into either a sufficient number of implied understandings to make it consistent with itself." Per Holmes, *C. J.*, in *Chase* v. *Boston* (*supra*).

"We shall certainly try to clear the doctrine of its difficulties, and end the supposed collision of authorities when the fit occasion comes; but to make the effort now would compel us to go entirely outside of

the very different question involved in this appeal." Per Finch, *J.*, in *Gillet* v. *Whiting* (*supra*).

"It seems to me, after as full an examination of the subject as circumstances have permitted, that the dissenting opinions of Grover and Woodruff, *JJ.*, in *Markham* v. *Jaudon*, embody the sounder reasons, and that the rule of damages laid down in that case and followed in the present one is not well founded and should not be sustained." Per Rapallo, *J.*, in *Baker* v. *Drake* (1st appeal), 53 N. Y., at page 225.

See also Dos Passos on Stockbrokers, 2d Edition, Chap. III, *sub nom* "Legal Relation of Stockbroker to His Client," where the difficulties of the New York view are frankly considered. Also Cook on Corporations, 5th Ed., Vol. II, §§457, 467, where opposing views are given without comment, and the dissenting opinion of Carpenter, *J.*, in Skiff *v.* Stoddard, 63 Conn., 236, who sides with Grover and Woodruff, *JJ.*

It was suggested by our opponents in the Court below, that inconsistencies are not confined to the New York doctrine; and it was pointed out how the Supreme Court of Massachusetts had at the same term decided in *Chase* v. *Boston* and in *Rice* v. *Winslow* that the requirements of one act were met by regarding the ownership of stocks carried on margin as being in the broker, and the prohibitions of another by looking at it as being in the customer.

However that may be, and the learned Court says there was none, the New York theory cannot avoid the charge.

In the latest case, *Leo* v. *McCormack*, 186 N. Y., 330, where a broker, who after carrying stocks on margin for a customer, had sold them, and before receiving the proceeds had settled with his customer, and on a suit by him against the purchasing broker to recover the price, was met by a defense of fraud on the part of his own principal in inducing the sale, the Court held that as to his advances before the sale he sued in the capacity of a pledgee in good faith selling the security, and so was unaffected by his principal's fraud; but as to the payment of the balance over his advances, though equally without knowledge of the fraud, he could not recover. A suspicion of his good faith seems, however, to lurk in the end of the opinion. This application of equity was made in a common law action to recover a contract price, and in a

suit to which his principal was not a party, and therefore not bound.

The case of *Kennedy* v. *Budd*, 5 App. Div., 140, is a forcible illustration as to how far the New York courts are compelled by facts to depart from the logic of a case, which was based on an assumption which had no existence in fact. Under *Markham* v. *Jaudon*, it was assumed that the customer had agreed to take the stocks off the broker's hands whenever so required by the latter, and it was on this assumption that the theory of pledgor and pledgee was worked out. We say assumption, because there was no evidence in the record of any such agreement, nor is there any custom from which it can be implied.

The question as to when a broker's cause of action against his customer is barred by the statute of limitations, had never come up in New York, nor elsewhere, it is believed, until *Kennedy* v. *Budd*. There a broker, after carrying a customer some years, died, and his executors more than six years after the "advances" sold out the stocks at a loss, rendered the usual account, and sued to recover the balance. The Trial Court, following *Markham* v. *Jaudon*, held that it was a suit to recover a loan, and while the right to foreclose the lien on the pledged securities may not have been barred, a suit to recover a balance due after crediting the proceeds of the sale, was barred. Under the logic of that decision this disposition of the case was sound. But the Appellate Division reversed the ruling, on the ground that a contract to carry stocks for a customer could not be defeated by a claim for immediate repayment, and that no cause of action accrued until after the contract for carrying had been terminated by one party or the other. In other words, the broker had no cause of action for advances, but only for a loss after sale on notice. Thus was *Markham* v. *Jaudon* virtually overruled. If there has been a series of transactions stretching over months, how could either sue the other except at law on an account stated, or in equity for an accounting?

The first pledge of the stocks is really to the banker, whose money provides for nine-tenths of the purchase price. When the broker does not in fact lend a dollar on the stock and pledges it to get nine-tenths of the purchase price, and pays it to the seller and not the cus-

tomer, why should the courts indulge in the fiction that *he* has advanced the money to his customer and his customer has pledged the stock to him, and then he has repledged it to the banker?

When that fiction tends to get the courts into, rather than the parties out of, trouble, why should it be followed? Ought it not to be treated as a will-o'-the-wisp?

5th. Can it be that there is a theory, which is based on the actual customs of the business, and which will not entail inconsistencies?

We ask the question with trepidation.

The common law has been developed by applying law to facts, and not by forcing facts to fit law. Shoes are made to fit feet, not feet to fit shoes. *Markham* v. *Jaudon* is a case of misfit. Purchases of stock for investment where the purchaser intends to put the stocks in his own strong box, and dealing in stocks for profit where the purchaser has no such intention, are two different things. The same legal principle will not fit them both. In thus dealing in stocks for profit, rather than for investment, there is no element of wagering under the gaming act, so long as there is an actual delivery of the certificates to the broker.

Bibb *v.* Allen, 149 U. S. 481;

Hurd *v.* Taylor, 181 N. Y. 231.

> The "purchase of stocks through a broker, though the party ordering such purchase does not intend to hold such stocks as an investment, but expects the broker to carry them for him with the design on the part of the purchaser to sell again the stocks when their market value has enhanced it, however speculative, is entirely legal." Per Cullen, *C. J.*, at page 233.

No doubt the customer in a speculative account has the right to take up the stocks, but this as a corollary and not a stipulated right or an obligation (see dissenting opinion of Woodruff, *J.*, in Markham's case, 41 N. Y., at p. 256).

> In connection therewith, it should be noted that his opinion in *Morgan* v. *Jaudon*, to which he refers (p. 255), was reported four years afterward in 40 How. Pr. 366.

It is by virtue of his obligation to keep his margin good and his broker's right to sell on notice if he fails to do so. The question how long a customer can compel a broker

to carry, left open as it is by the parties, has never been closed by the courts. We presume that the rule as to reasonable time would apply. Also that termination is by the will of either party.

Contracts between broker and customers are not usually in writing; neither are they spoken in all their details. The transaction is conducted according to custom, and the contract must be arrived at by ascertaining the custom upon direct proof or through judicial notice.

The evidence in this record of what the broker and customer did in the case at bar accords with what is generally known as usage in respect of speculative accounts.

Therefore we submit that in the absence of any written contract, or proof of any definite talk between this broker and these customers on opening the account, the only way to get at the agreement between them, is to see what they did and then decide what their acts necessarily imply.

These respondents started a speculative account on February 10, 1903, by paying the broker a margin of $500 (Record, p. 29); he bought stocks for $3,987.50 not only under the *lex loci* giving him the right, but also by special understanding with his customers that he could pledge such stocks on general loan. As it appears that at the end of the account in the following June all the stocks he was then carrying for them, including those which they put up as margin instead of cash, were found pledged on general loan, the inference is fair that he paid for the stocks bought February 10th, as well as for all subsequent purchases out of the proceeds of general loans added to the respondents' margins. From time to time he bought various stocks, sold various stocks, received from respondents various sums of money, paid them various sums of money, rendered accounts from time to time, and in June they had a margin with him of 20 to 25 per cent.

According to the proved custom, and therefore a part of the agreement, respondents were only bound to keep a margin of 10 per cent. The account shows profits, and they had a right to demand them. They did "demand" $5,000, and next day respondents demanded the certificates, threatening attachment, and he arranged it so that with $34,919.62 of their own money, of which $5,000 had become theirs two days before on its payment by him,

they could pay it, as they did pay it, directly to the pledgee and obtain securities worth $45,583.75. In their account there is no direct item charged for commissions, the custom being to add the commission of one-eighth of one per cent. to the price of stocks on purchases and to deduct it on sales. The commission is, however, there and must be taken into account.

Such are the facts where the venture has been successful. Where it is unsuccessful, the broker informs the customer that unless more margin is put up the stocks will be sold, or in case of short sale, other stocks will be purchased on the customer's account at the market price; the sale or purchase, as the case may be, takes place, and the gain or loss is ascertained upon an account rendered. The parties in this case stated an account, as is always the case.

Now, the question is, what is the principle of law which must be applied to those facts, in order to determine their relation. As to their respective rights in selling out stock with or without notice, this case is not concerned.

We humbly ask, whether a speculative account in stocks as thus actually carried on is anything other than a joint adventure?

As a matter of fact, the customer and the broker combine to provide money for speculation in stocks upon terms, which shall yield one of them a certain return called commissions, and the other an uncertain return called profits, the latter to make good to the other all losses. It is of the essence of that form of joint adventure called a partnership that there is a community in profits and losses. But in those combinations of capital or services, or both, which for convenience are called joint adventures, as distinguished from partnerships, the parties may by adherence to custom or by special arrangement agree to such apportionment of losses and profits and to other terms as they please. If they choose to call the gains of one profits, and of the other commissions, shall the Courts say them nay, and hold the letter above the spirit?

6th. The theory of joint adventure is submitted as one, which grows out of the customs "of the street," and which will in every case work exact and equal justice to the parties themselves and their creditors, without leading to inconsistent decisions. It lends itself to every

divergence from those customs, which the parties may make by express stipulation. In the law of contract the joint adventure occupies a position analogous to the action on the case in the law of pleading.

In the development of this part of the common law, is not the time ripe for a final deliverance as to the true relation between stock broker and customer? Is not the tribunal, which is supreme above all discordant voices, the place? Is not a cause, which calls loudly for the application of the fundamental principle of the bankrupt law, the occasion?

Speculation in stocks on margins is a modern thing.

In 1770, Lord Mansfield, in speaking of certificates of stock, said:

> "This is a new species of property arisen within the compass of a few years."
>
> Nightingale *v.* Devinne, 5 Burr., 2589.

Such transactions are impossible without a Stock Exchange. That in New York was not founded until 1817 and "with 1820 the real history of the Exchange may properly be said to commence."

> Dos Passos on Stockbrokers, 2d Ed., Vol. 1, pp. 11-12, note.
>
> The N. Y. act against stock jobbing, 2 Rev. Laws, p. 187, §18, re-enacted in 1 Rev. Stat., 720 (Tit. 19, art. 2), was repealed by chap. 134 of the Laws of 1858.

The customer on speculation bent, with insufficient funds, got round the law making actual delivery of the certificates necessary to a valid sale, by asking the broker to "carry" him. Thus the delivery to the broker satisfied the law, and the broker's willingness to provide nine-tenths of the purchase money satisfied the customer, and speculation has gone merrily on, with no hindrance from the courts unless an intention distinctly appears that no stock was to be bought and the speculation was only in "differences." Men will invest in stocks as in potatoes or wheat. Controversies will arise. Justice must be done.

The meaning of the verb "to carry" as applied to stocks, which a customer does not intend to take up, has only crept into dictionaries of late. Even in 1858 its use was new to the Court. See Saltus *v.* Genin, 3 Bosw., at p. 260, where Duer, *J.*, says that "it seems" to mean

so and so. The business world was better acquainted. Horton *v.* Morgan, 19 N. Y. (1859).

7th. If such a theory were found to be the true one, the following would be some of the necessary corollaries:

(a) The interests of the parties are to be worked out by means of an accounting.

This is the way the parties always do work them out when they do it for themselves. It was done in this case. Shall the courts ignore it?

(b) Until the account is made up they cannot tell where they stand, i. e., in exact figures.

Is not this always the case in any partnership or any other joint adventure?

Sale of stocks on notice presents no difficulties under this theory.

(c) If on a given day an accounting would show that either is under obligation to give anything to the other, whether in money or stocks, then it is that one who is the debtor upon a chose in action.

(d) Neither owns the securities as against the other; both have a common right to them to the extent of their interest, as it may appear upon an accounting.

It is immaterial where the legal title to the certificates is. This is always so in equity; *e. g.*, partnerships in land.

As a matter of fact the legal title is always in the broker, so that he may collect dividends, and may be transferred to the banker for the same purpose.

(e) The fact that no one can tell how the parties stand on a given day, except by a subsequent accounting, no more militates against the application of the bankrupt law to their relations, than the fact that no one can tell how partners stand, prevents the application of the bankrupt law to preferences between partners.

Suppose on an accounting of a co-partnership it is found that one of the partners is indebted to the other, that his indebtedness has, in fact, existed for several months, during which time he has really been insolvent and that within four months of his individual bankruptcy and prior to the accounting, by which these facts were determined, he had turned over to his partner certain property, would that preference be good as against his other individual creditors, assuming knowledge of insolvency?

(f) The fact that the fluctuations in the stock market may change the obligations of the parties to each other from day to day, so that the customer may be indebted to the broker on one day, or be his creditor on another, may complicate the situation, but does not change the nature of the relation.

8th. Under such a theory there would be no difficulty in applying to a transaction like the one at bar the rule, equality is equity.

The broker, being interested in joint adventures with an hundred different customers, rightly acting for each by agreement or custom in pledging the stock of the different adventurers *en masse* on general loan, necessarily would create a situation where, if insolvent, he would be found upon an accounting indebted to each of those customers, even as an insolvent partner in several solvent firms may be found to be indebted to each, and must not prefer any.

9th. This theory was submitted to the Court below, as it is here, purely as a subordinate point, only necessary to be considered in case our main one is not well taken. It was not anticipated that the learned Court below would be so impressed with the importance of following *Markham* v. *Jaudon* and not vexing the financial center of the country by a serious conflict of authority between itself and the courts of New York, that it would overlook what we earnestly urged below, and press here, as the main point.

III.

There are three other points in this record, minor though they be, which ought not to be overlooked.

1st. If parties by their conduct render an accounting necessary, and at the close of their dealings state their account, by which it appears that one owes the other money, and on its tender the other must deliver property of greater value than the money, this of, by, and in itself constitutes the latter a debtor, for on a liquidation of damages upon a failure to comply, the balance would be against him.

This is exactly what happened at bar. In every case of where a broker carries stocks for a customer in a speculative account on margins, an accounting is necessary to ascertain how they stand. Can it make any difference, whether in stating that account, they adjust it by transferring securities instead of cash?

This theory is to some extent sustained by authority.

In re Topliff, 114 Fed. Rep. 423.

2nd. The payment by the insolvent to the respondents of $5,000 on June 24th, if it is to be considered by itself and not a part of a three-day transaction, was a clear preference.

The respondents neither begged, borrowed nor stole that money; they demanded it as of right. Under the custom "of the street" (*supra*), that they need only keep good a margin of 10 per cent., the broker was bound *ex contractu* to pay it to them. It represented in part profits, as shown by the account.

Cash payments were made "on account" to and fro, as follows:

They paid him "on account," 1903:		He paid them "on account":	
February 10	$ 500	April 7	$2,000
February 25	500	May 11	2,000
May 20	2,000	May 29	1,000
May 20	1,000	June 1	1,000
May 25	2,000	June 3	1,000
June 5	1,000	June 8	1,000
June 10	1,785	June 10	1,000
June 10	3,000	June 24	5,000
	11,785		14,000

Record, pages 29-34.

Thus it appears that, while there may have been losses, their gains in the end were $2,215 in cash, and $10,664.13 in securities, upon an initial investment of $1,000.

Hence the $5,000 paid on demand, pursuant to contract, was a payment, not a loan.

Payments of money fall within the category of transfers of property.

Pirie *v.* Chicago T. & T. Co., 182 U. S. 438.

See also,

Jacquette *v.* Alden, 189 U. S. 78;
N. Y. Co. Bank *v.* Massey, 192 U. S. 138;
Yaple *v.* Dahl-Millihan Co., 193 U. S. 526.

3rd. The fact that of the securities redeemed from the banker on June 26th, the two Shannon bonds were the identical bonds which respondents had owned and turned over to the broker as part of their margin, does not operate to reduce the preference by the amount they represent.

The securities delivered to the defendants on June 26th fall into three categories:

(1) Stocks which had been bought by the bankrupt on their account (Ex. 10, first column, page 41).

(2) Stocks which had been turned over by defendants to the bankrupt as margin in place of cash (*id*, second column).

(3) Bonds, to wit, the two Shannon bonds, turned over for the same purpose (pp. 14, 18, 41), and regained on the settlement (p. 23).

In respect of the stocks, whether bought for the defendants or turned over by them to the bankrupt as margin, the defendants never had title to the specific certificates, which were finally delivered to them (p. 23).

Therefore, as to the stocks, they never got back any property to which they ever had any title.

As to the two Shannon bonds, they did, as just stated, get back the identical bonds, but we submit that this fact makes no difference.

These bonds were pledged by the bankrupt with the other securities under the agreement with the defendants that they might be so pledged. Having parted with their control he was unable to get them back without a payment of money or a transfer of property of some kind. That is, he had to give up property of his own. The defendants were unable to obtain any of the securities, including these bonds, thus pledged by the bankrupt, without producing the amount for which they had been pledged. They did not, in fact, pay the bankrupt anything at all on June 26, and did not get their bonds from him.

True, the defendants got back bonds to which they once had title. But when they turned over those bonds to the bankrupt as margin, with an agreement that he might pledge them upon his general loans, they put it out of

their power to go to such pledgee and enforce their delivery on tender of the balance due on their purchases. A creditor is not bound to receive part payment of his debt. Hence even as to these bonds, they simply had a chose in action against the insolvent. In other words, those bonds are to be treated, exactly as the parties meant, as so much cash. Be that as it may, the fact is that they only got back these bonds through a transfer by the bankrupt to them of property of his own, to wit, his "margin," with Brown, Riley & Co.

Whether the transfer be called, as it was in *Weston* v. *Jordan*, a transfer to defendants "of the excess of the value of the shares so delivered to them above the sum then paid to the broker therefor," or a transfer to them of such excess above the sum paid to the pledgees therefor, or a transfer by oral assignment of an interest to that extent in the insolvent's margin with the pledgees, is immaterial.

IV.

We submit that a case of preference to the extent of $15,664.13 in cash and securities was made out; the trustees' request to go to the jury on the question of the defendants' knowledge of the insolvency should have been granted; its denial was error; the exception thereto was well taken; the judgment should be reversed and a new trial should be granted, with costs to the petitioner.

JOHN BROOKS LEAVITT,
HENRY ARNOLD RICHARDSON,
Of Counsel.

JAN 16 1908
JAMES H. McKENNE
CLE

Supreme Court of the United States,

OCTOBER TERM, 1907.

No. 122.

HENRY ARNOLD RICHARDSON, as Trustee in Bankruptcy of J. Francis Brown,

Petitioner,

against

JOHN M. SHAW AND ALEXANDER DAVIDSON,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

RESPONDENTS' ARGUMENT.

LOUIS MARSHALL,
Of Counsel for Respondents.

B. H. TYRREL, PRINTER, 206-208 FULTON STREET, NEW YORK.

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No. 122.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

Respondents' Points.

The importance of the precedent that will be established in this case, is a justification for the presentation of an additional brief on behalf of the respondents on this hearing, in order that the fundamental proposition may be presented in the most simple form.

The action was brought in the United States District Court for the Southern District of New

York, by the trustee in bankruptcy of J. Francis Brown, a stockbroker doing business in the City of Boston, Massachusetts, against John M. Shaw and Alexander Davidson, citizens of New York, to recover the sum of $15,664.13, on the claim that the respondents had received money, stocks and securities to that amount as an unlawful preference, in order to enable them, *as creditors*, to obtain a greater percentage of their debt than any other of the creditors of the bankrupt in the same class. (Rec., pp. 4, 5.) The respondents denied the charge. (Rec., p. 6.)

The proof showed, that during the year 1903 the respondents, in the name of their agent Royal B. Young, purchased various classes of stocks extensively through Brown, paying to the latter from time to time margins, either in cash or by the deposit of securities, to an amount of at least ten per cent of the purchase price of the stocks. From time to time stocks which were so purchased were, on the direction of the respondents, sold by Brown, and the proceeds credited to the respondents' account, and they occasionally drew against this account, but at no time leaving with Brown a margin of less than ten per cent (Rec., p. 16).

On June 24, 1903, the respondents received from Brown $5,000, their margin being at that time over thirty per cent (Rec., pp. 11, 18, 19), and on June 26, 1903, the respondents demanded their stocks from Brown, paying him the balance of their indebtedness on account of the purchase of the shares, and the stocks were delivered in compliance with this demand. It is these transactions which are claimed to constitute the preference against which redress is sought in this action.

The testimony as to the relations between the

parties is clear. Lawrence B. Fletcher, the clerk of the bankrupt, says (Rec., p. 11):

"Brown bought and sold stocks for Shaw & Company upon orders of R. B. Young, who had an office in Boston, as stockbroker; Shaw & Company did business in New York City, general stockbrokers. Am acquainted with the method of transacting business between Shaw & Company and J. Francis Brown; our office, 15 Congress street, Boston; Shaw & Company had quite an account with us; were carrying a good many stocks, buying and selling; had a liberal margin, keeping a ten per cent margin on their stocks; paid cash as margin from time to time; beginning in February; Brown & Company sent them money at times; the stocks were figured at the market value every day, that is the going price at 10 o'clock in the morning, at 12 o'clock or 3 o'clock, whenever the slip came in; the accounts were carried on the books as R. B. Young, Attorney; statements of the account were rendered to Young of the various purchases and sales of stock, rendered on forms similar to those put in evidence."

These accounts, specimens of which appear Record pages 27-42, each contained the following statement at the top:

"It is understood and agreed that all securities carried in this account or deposited to secure the same may be carried in our general loans and may be sold or bought at public or private sale, without notice, when such sale or purchase is deemed necessary by us for our protection."

At Record, page 14, the witness proceeds:

"The ledger is here; it shows all the stocks that J. Francis Brown & Company were carrying on that date; I want the jury to understand that I have a recollection that this statement or mem-

orandum which Royal Young sent me on June 26th contained a balance struck; I have already testified that he told me that he wanted his stock; I was to deliver stocks and he was to pay the balance of the purchase price upon them; the occasion there was to strike a balance in money, when he was to take the stocks and pay us all he owed us, was in order to have us deliver the stocks to him; he would have to pay us the correct amount of his indebtedness to the cent on the ledger; in order to send me the amount of his indebtedness to us, he would have to strike his balance against us."

At Record page 15 he says:

"He told me to take the stocks and deliver them to the Beacon Trust Company and I would get a check from them for these stocks; the amount was not stated; the amount had been on the statement he sent me that morning; this amount on Exhibit 3, $34,919.52; I took the stocks to the Beacon Trust Company, as he directed, and delivered them to the President; got a check for this amount $34,-919.52."

On his cross-examiaation the witness says (Rec., p. 16):

"The transaction commenced in February, 1903, I think, and closed at the end of June, about six months; during that time John M. Shaw, through Young, had occasion to draw money from time to time in various sums; a dozen times or more; in sums of $1,000 up; and that was when there were varying credits to their account and they were drawn down; credits above the amount of margin stipulated between our firm and theirs; the agreement was to keep ten per cent, I think; so that when it got up to about thirty per cent it was not an unusual thing for them to draw down some money; before they drew the $5,000 the market

had crept up to some thirty per cent, I think; it was absolutely in the usual course of business for them to draw that $5,000; when I had the talk with Royal Young, preceding the assignment two or three days, he wanted his stock and was prepared to pay us the money; he was ready to pay his debit balance, and demanded of me to give him the stock that we had on deposit in our business, which we were carrying for his account; we were carrying so many stocks and he owed us so much money; and when he paid the money we were bound to deliver him the stocks."

At Record page 18, referring to the account between Brown and the respondents, the witness says:

"On June first the debit balance was $24,238.68; on June 26th the debit balance increased to $34,919.62, if these figures are correct; so that on June 1st Shaw & Company owed our firm twenty-four thousand and odd dollars, against a lot of stock that we were carrying for them, and on June 26 they owed us thirty-four thousand and odd dollars against a lot of stock that we were carrying for them; if they had not drawn out the $5,000 on the 24th they would have owed us twenty-nine thousand dollars and odd."

At Record page 20 he says:

"If these stocks which we were carrying for John M. Shaw & Company made a profit, that profit belonged to Shaw over and above his balance; we didn't figure it as a profit, everything belonged to Shaw over and above what he owed us; stocks and dividends, interest and profits, all belonged to Shaw over and above what Shaw owed us on account of the stocks; and when Shaw paid us finally the $34,919.62 he paid his debt to us; when dividends were declared they were credited up; that's the custom among brokers in Boston, to

credit dividends and charge interest on debit balances."

At the close of the petitioner's testimony, a verdict was directed in favor of the respondents, on grounds stated in the opinion of Judge Holt (Rec., pp. 24-26), and on appeal to the Circuit Court of Appeals for the Second Circuit, this decision was unanimously affirmed, the opinion of Judge Coxe appearing at Record pages 43-48.

The petitioner claims that, under the Bankrupt Law, the respondents were creditors of Brown, and that the delivery to the respondents of the shares of stock which the bankrupt was carrying for them, constituted a preference over other creditors of the same class.

This proposition is disputed by the respondents, it being their contention that they were not creditors, but debtors of Brown, and that the shares of stock which were delivered to them were their property, held by Brown, as security for the repayment to him by the respondents of their indebtedness.

POINTS.

I.

The relation between Shaw & Company and the bankrupt with regard to the shares of stock purchased by the latter for the former, was that of pledgor and pledgee, the bankrupt being the creditor of Shaw & Company, to the extent of any advances made in connection with the purchase of the stock, in excess of the margins deposited with him; hence a violation of Section 60 of the Bankrupt Act cannot be predicated upon the payment by Shaw & Company of their indebtedness to the bankrupt, and the receipt of the securities for which such indebtedness had been incurred.

Section 60a of the Bankrupt Law, upon which this action is based, reads as follows:

"A person shall be deemed to have given a preference if, being insolvent, he has within four months before the filing of the petition, or after the filing of the petition and before the adjudication, procured or suffered a judgment to be entered against himself in favor of any person, or made a transfer of any of *his* property, and the effect of the enforcement of such judgment or transfer will be to enable any one *of his creditors* to obtain a greater percentage of *his debt* than any other of *such creditors* of the same class."

It is evident, that in order to bring a case within this statutory provision, the bankrupt, being a debtor, must make a payment or transfer of his property to a creditor. The bankrupt must occupy the conventional relation of debtor, and the property transferred must be his property. If, therefore, in the present case, the bankrupt was the creditor, and not the debtor, and the property transferred was the property of Shaw & Company, and not of the bankrupt, no case is presented which comes within the scope of the section of the Bankrupt Act on which the petitioner relies.

Nor was a delivery to the respondents of the shares of stock which Brown was carrying for them, and which remained under his control a preferential transfer of the bankrupt's property within the meaning of Section 60a.

New York County National Bank v. *Massey, 192 U. S., 138.*

It was there held that the balance of a regular bank account at the time of filing a petition in bankruptcy is a debt *due to the bankrupt* from the bank, and in the absence of fraud or collusion between the bank and the bankrupt with a view of creating a preferential transfer, the bank need not surrender such balance, but may set it off against notes of the bankrupt held by it, and prove its claim for the amount remaining due on the notes. Mr. Justice Day said:

"But it is urged that under section 60a this transaction amounts to giving a preference to the bank by enabling it to receive a greater percentage of its debts than other creditors of the same class. A transfer is defined in section 1 (25) of the act to include the sale and every other and

different method of disposing of or parting with property, or the possession of property, absolutely or conditionally, as a payment, pledge, mortgage, gift or security. While these sections are not to be narrowly construed so as to defeat their purpose, no more can they be enlarged by judicial construction to include transactions not within the scope and purpose of the act. This section 1 (25), read with sections 60a and 57g, requires the surrender of preferences having the effect of transfers of property 'as payment, pledge, mortgage, gift or security which operate to diminish the estate of the bankrupt and prefer one creditor over another.' The law requires the surrender of such preferences given to the creditor within the time limited in the act before he can prove his claim. These transfers of property, amounting to preferences, contemplate the parting with *the bankrupt's property* for the benefit of the creditor and the consequent diminution of *the bankrupt's estate.* It is such transactions, operating to defeat the purposes of the act, which under its terms are preferences."

It therefore becomes important to consider the nature of the relation between the bankrupt and the respondents, in order to ascertain which of the two was the creditor at the time when the transactions between them were closed, and the bankrupt delivered to the respondents, on payment by the latter of $34,919.62, the shares of stock which the bankrupt had purchased for them.

1. *The bankrupt regarded Shaw & Co. as his debtors.*

It is to be observed from the testimony, that in speaking of the relations between the two concerns, the respondents are referred to as "indebted" to J. Francis Brown & Company. The amount

which they were to pay for the shares is spoken of as "a balance of the purchase price," as the respondents' "indebtedness," as the latter's "debit balance." It was said that the respondents "owed us (Brown) so much money," and that "when he paid the money we were bound to deliver to him the stocks." The $34,919.62 which were paid on June 26th, were referred to as money "Shaw & Company owed us (Brown)," and "if they had not drawn out the $5,000 on the 24th, they would have owed us twenty-nine thousand dollars and odd."

2. *The written evidence indicates the understanding to have been that the securities carried for Shaw & Co., were theirs.*

The notice which appeared on each of the accounts rendered by the bankrupt to the respondents, expressly recognized that the securities carried in the respondents' account were the property of the latter, and not the property of Brown. The reservation by the latter of the privilege to use the securities which were thus carried, in his general loans, and of selling them if necessary for his protection, was obviously predicated upon a recognition by him of the fact, that but for such reservation the respondents, being the owners of the securities so carried, might have prevented him from carrying out his purpose in that regard. If the securities carried in the account, or deposited to secure the account, were Brown's property, there would have been no need for expressing such a reservation. He could have done with them whatever he desired.

It is also significant in this connection to ob-

serve, that securities carried in the account were placed in the same category as those deposited to secure it; in other words, that stocks and bonds delivered by the respondents to Brown as security, were placed in the same category as securities purchased by Brown for the respondents.

3. *The same result follows from the rule established by the general consensus of judicial opinion, applicable to the circumstances here disclosed.*

Irrespective of these considerations, which indicate what the actual agreement between the parties was, and what their understanding was, as to the nature of their relations, we contend that under general principles of jurisprudence, and the great weight of authority in the United States, the same result would follow.

(a) The petitioner practically admits that the rule in most of the jurisdictions where the relation between a broker and the purchaser of stock on a margin transaction has been raised, the respondents' contention has been sustained; but he argues, that the rule in Massachusetts is to the contrary, and that inasmuch as the transactions, which are under investigation here, occurred in Massachusetts, the law of that commonwealth must control.

(b) This theory is, however, erroneous, since the question under consideration is not one of local law, but of general commercial law, and is to be decided by the Federal Courts on principles of general jurisprudence, irrespective of the decisions of the courts of the State, where the transac-

tion under investigation had its inception, there being here no question as to the validity of the contracts between Brown, and the respondents, under the local law of Massachusetts, whether statutory or otherwise.

In *Swift* v. *Tyson, 16 Pet., 1*, which arose in the Circuit Court of the United States for the Southern District of New York, and which involved the question as to what constituted a *bona fide* holder of a negotiable instrument, a decision was reached by this court in contravention of the rule announced by the New York Court of Errors in *Bay* v. *Coddington, 20 Johns., 637*, Mr. Justice Story saying:

"But, admitting the doctrine to be fully settled in New York, it remains to be considered, whether it is obligatory upon this court, if it differs from the principles established in the general commercial law. It is observable, that the courts of New York do not found their decisions upon this point, upon any local statute, or positive, fixed or ancient local usage; but they deduce the doctrine from the general principles of commercial law. It is, however, contended, that the 34th section of the judiciary act of 1789, ch. 20, furnishes a rule obligatory upon this court to follow the decisions of the state tribunals in all cases to which they apply. That section provides 'that the laws of the several states except where the Constitution, treaties or statutes of the United States shall otherwise require or provide, shall be regarded as rules of decision, in trials at common law in the courts of the United States in cases where they apply.' In order to maintain the argument, it is essential, therefore, to hold, that the word 'laws,' in this section includes within the scope of its meaning, the decisions of the local tribunals. In the ordinary use of language, it will hardly be contended that the decisions of courts constitute

laws. They are, at most, only evidence of what the laws are, and are not of themselves laws. They are often re-examined, reversed and qualified by the courts themselves, whenever they are found to be either defective or ill-founded, or otherwise incorrect. * * * It never has been supposed by us, that the section did apply, or was designed to apply to questions of a more general nature, not at all dependent upon local statutes or local usages of a fixed and permanent operation, as, for example, to the construction of ordinary contracts or other written instruments, and especially to questions of general commercial law, where the state tribunals are called upon to perform the like functions as ourselves, that is, to ascertain, upon general reasoning and legal analogies what is the true exposition of the contract or instrument, or what is the just rule furnished by the principles of commercial law to govern the case. And we have not now the slightest difficulty in holding, that this section, upon its true intendment and construction, is strictly limited to local statutes and local usages of the character before stated, and does not extend to contracts and other instruments of a commercial nature, the true interpretation and effect whereof are to be sought, not in the decisions of the local tribunals, but in the general principles and doctrines of commercial jurisprudence. * * * It becomes necessary for us, therefore, upon the present occasion, to express our own opinion of the true result of the commercial law upon the question now before us."

This doctrine has been applied in a multitude of cases, of which a few illustrative citations may be added:

Chicago v. *Robbins, 2 Black, 418.*
Gelpke v. *City of Dubuque, 1 Wall. 175.*
Railroad Co. v. *Lockwood, 17 Wall. 357.*

Boyce v. *Tabb, 18 Wall. 548.*
Oates v. *National Bank, 100 U. S. 246.*
Railroad Co. v. *National Bank, 102 U. S. 29, 30.*
Burgess v. *Seligman, 107 U. S. 34.*
Myrick v. *Michigan Cent. R. R. Co., 107 U. S. 102.*
Pana v. *Bowler, 107 U. S. 541.*
Smith v. *Alabama, 124 U. S. 365, 378.*
Liverpool Steam Co. v. *Phenix Insurance Co., 129 U. S. 443.*
Baltimore & Ohio R. R. Co. v. *Baugh, 149 U. S. 371.*
Washburn & Moen Mfg. Co. v. *Reliance Insurance Co., 179 U. S. 1, 15.*

In *Liverpool Steam Co.* v. *Phenix Insurance Co., supra,* Mr. Justice Gray said:

"It was argued for the appellant, that the law of New York, the *lex loci contractus,* was settled by recent decisions of the Court of Appeals of that state in favor of the right of a carrier of goods or passengers, by land or water, to stipulate for exemption from all liability for his own negligence. Mynard *v.* Syracuse Railroad, 71 N. Y. 180; Spinetti *v.* Atlas Steamship Co., 80 N. Y. 71. But on this subject as on any question depending upon Mercantile law, and not upon local statute or usage, it is well settled that the courts of the United States are not bound by decisions of the courts of the state, but will exercise their own judgment, even when their jurisdiction attaches only by reason of the citizenship of the parties, in an action at law of which the courts of the state have concurrent jurisdiction, and upon a contract made and to be performed within the state."

In *Washburn & Moen Mfg. Co.* v. *Reliance Insurance Co., supra,* which was an action involving the interpretation of a policy of marine insurance, Mr. Chief Justice Fuller said:

"It is said that a different rule has been laid down in Massachusetts by the Supreme Judicial Court of that Commonwealth. Kettell *v.* Alliance Ins. Co., 10 Gray, 144; Mayo *v.* India Mut. Ins. Co., 152 Mass. 172. Even if this were absolutely so we should not feel constrained, though regretting the difference of opinion, to depart from our own rule. The policy was a Massachusetts contract, it is true, but its construction depended on questions of general commercial law, in respect of which the courts of the United States are at liberty to exercise their own judgment and are not bound to accept the State decisions as in matters of purely local law."

In *Myrick* v. *Michigan Central R. R. Co., supra,* Mr. Justice Field said:

"Our attention has been called to some decisions of the Supreme Court of Illinois, which would seem to hold that a railroad company which receives goods to carry, marked for a particular destination, though beyond its own line, is *prima facie* bound to carry them to that place and deliver them there; and that an agreement to that effect is implied by the reception of goods thus marked. * * * Assuming that such is the purport of the decisions, they are not binding upon us. What constitutes a contract of carriage is not a question of local law, upon which the decision of a State court must control. It is a matter of general law, upon which this court will exercise its own judgment. * * * If the doctrine of the Supreme Court of Illinois, as to what constitutes a contract of carriage over connecting lines of railroad, is sound, it ought to govern, not only in Illinois, but in other States; and yet the tribunals of other

States, and a majority of them, hold the reverse of the Illinois court, and coincide with the views of this court. Such is the case in Massachusetts. * * * If we are to follow on this subject the ruling of the State courts, we should be obliged to give a different interpretation to the same act —the reception of goods marked for a place beyond the road of the company—in a different States, holding it to imply one thing in Illinois and another in Massachusetts."

It must necessarily follow from this doctrine, that this court is not bound to follow the rule, which the petitioner denominates the Massachusetts rule, but will be guided by that rule which is conceived to be best adapted to the commercial conditions which generally prevail throughout the country, and which has been successfully and satisfactorily applied in a myriad of instances, in jurisdictions in which transactions of the character considered in the present case, occur hundreds of times on every business day, involving hundreds of millions of dollars.

That rule, as announced in a host of cases, is, that when a broker purchases for a customer stock upon a margin, the legal title to the stock vests in the customer. The relation of debtor and creditor exists between the customer and broker, as to the unpaid balance of the purchase money, and the stock being in the possession of the broker, it is deemed pledged to him as security for such unpaid balance. The relation of pledgor and pledgee therefore arises, with this qualification to the usual rule applicable to such relation, that it is not necessary for the broker to retain in his possession the identical stock purchased by him on his customer's order, but it is sufficient if he has in his possession,

or under his control, a quantity of the stock in question equal to that purchased, which he can deliver to the customer when the account is closed.

This doctrine is admirably stated by Mr. Justice Prentice in *Skiff* v. *Stoddard, 63 Conn., 198; s. c., 21 L. R. A., 102, 113,* where he says:

"The leading case upon this subject in New York is *Markham* v. *Jaudon, 41 N. Y., 235.* The opinion of the court in that case, delivered by Chief Justice Hunt, contains an analysis of the obligations of the parties to a margin-purchasing contract which is so exhaustive, and so in consonance with our views, in so far as it relates to the questions involved in this case, that we quote it in full, together with some further pertinent observations of the court, as follows: 'The broker undertakes and agrees (1) at once to buy for the customer the stock indicated; (2) to advance all the money required for the purchases beyond the ten per cent. furnished by the customer; (3) to carry or hold such stocks for the benefit of the customer so long as the margin of ten per cent. is kept good, or until notice is given by either party that the transaction must be closed. An appreciation in the value of the stocks is the gain of the customer and not of the broker; (4) At all times to have in his name and under his control, ready for delivery, the shares purchased, or an equal amount of other shares of the same stock. (5) To deliver such shares to the customer when required by him, upon the receipt of the advances and commissions accruing to the broker; or (6) to sell such shares, upon the order of the customer, upon payment of the like sums to him, and account to the customer for the proceeds of such sale. Under this contract the customer undertakes (1) to pay a margin of ten per cent. on the current market value of the shares; (2) to keep good such margin according to the fluctuations of the market; (3) to take the shares so purchased on his order whenever required by the broker, and to pay the

difference between the percentage advanced by him and the amount paid therefor by the broker. The position of the broker is twofold. Upon the order of the customer he purchases shares of stocks desired by him. This is a clear act of agency. To complete the purchase he advances from his own funds, for the benefit of the purchaser, ninety per cent. of the purchase money. Quite as clearly he does not in this act as an agent, but assumes a new position. He also holds or carries the stock for the benefit of the purchaser until a sale is made by the order of the purchaser, or upon his own action. In thus holding or carrying he stands also upon a different ground from that of a broker or agent, whose office is simply to buy and sell. To advance money for the purpose, and to hold and carry stocks, is not the act of a broker as such. In so doing he enters upon a new duty, obtains other rights, and is subject to additional responsibilities.' The conclusion of the court is that this new relation is that of pledgor and pledgee. This doctrine has been adopted and approved by a long line of New York cases, among which are the following: *Stenton* v. *Jerome, 54 N. Y., 480; Baker* v. *Drake, 66 N. Y., 518, 23 Am. Rep., 80; Gruman* v. *Smith, 81 N. Y., 25; Capron* v. *Thompson, 86 N. Y., 418; Gillett* v. *Whiting, 120 N. Y., 402; Willard* v. *White, 56 Hun, 581.* The Supreme Court of Illinois has held in accordance with the rule in New York. *Brewster* v. *Van Liew, 119 Ill., 554.* The text-writers have adopted this view. *Dos Passos, Stockbrokers, 112; Cook, Stock & Stockholders, § 457; Jones, Pledges, 495; 18 Am. & Eng. Encyclop. Law, 707; Colebrooke, Collateral Securities, § 306; Overton, Liens, 205.*"

The rule of *Markham* v. *Jaudon* has been adopted and followed in New York in many other decisions, of which the following are but a part:

Stewart v. *Drake, 46 N. Y., 449.*
Stenton v. *Jerome, 54 N. Y., 480.*

Baker v. *Drake, 53 N. Y., 211; 66 N. Y., 518.*
Taussig v. *Hart, 58 N. Y., 425.*
Gruman v. *Smith, 81 N. Y., 25.*
Capron v. *Thompson, 86 N. Y., 418.*
Caswell v. *Putnam, 120 N. Y., 154.*
Gillett v. *Whiting, 120 N. Y., 402; 141 N. Y., 73.*
Minor v. *Beveridge, 141 N. Y., 399.*
LeMarchant v. *Moore, 150 N. Y., 209.*
Rothschild v. *Allen, 90 App. Div., 233; affd. 180 N. Y., 561.*
Hurd v. *Taylor, 181 N. Y., 231.*
Tompkins v. *Morton Trust Co., 91 App. Div., 279; affd. 181 N. Y., 578.*
Content v. *Banner, 184 N. Y., 121.*
Kennedy v. *Budd, 5 App. Div., 140.*
Douglass v. *Carpenter, 17 App. Div., 329.*
Strickland v. *Magoun, 119 App. Div., 113.*
Andrews v. *Clerke, 3 Bosw., 585.*
Taylor v. *Ketcham, 5 Rob., 507.*
Chamberlain v. *Greenleaf, 4 Abb. N. C., 478.*
Willard v. *White, 56 Hun., 581.*

The same rule has also been adopted in California, in

Child v. *Hugg, 41 Cal., 519.*
Thompson v. *Toland, 48 Cal., 99.*
Cashman v. *Root, 89 Cal., 373.*

As has already been seen, it was also accepted in Connecticut in

Skiff v. *Stoddard, 63 Conn., 198.*

It has also been applied in Pennsylvania, in

Gilpin v. *Howell, 5 Pa. St., 41.*
Wynkoop v. *Seal, 64 Pa. St., 361.*
Esser v. *Linderman, 71 Pa. St., 76.*
Hopkins v. *O'Kane, 169 Pa. St., 478.*

also in Maryland, in

Maryland Life Ins. Co. v. *Dalrymple, 25 Md., 242.*
Baltimore Ins. Co. v. *Dalrymple, 25 Md., 269.*

and in like manner in Illinois, in

Brewster v. *Van Liew, 119 Ill., 554.*

In the case last cited Mr. Justice Sheldon said:

"The relation which exists between a broker and his customer in the case of the holding and carrying of stocks, as here, is declared in the leading case of *Markham* v. *Jaudon, 41 N. Y., 235*, defining the relative rights and duties of the broker and customer. It is there laid down that, in advancing the money by the broker to complete the purchase of the stock, the relation of debtor and creditor is created, and that thereupon the broker becomes a pledgee of the stock for the money advanced in its purchase; that the contract between the parties is in spirit and effect, if not technically and in form, a contract of pledge."

In *Cashman* v. *Root, supra,* the Supreme Court of California said:

"This view of the relation between the broker and his customer in such a transaction is sustained by the weight of authorities in this country and in England; but the decisions are by no means uniform. The first prominent case on the point is *Markham* v. *Jaudon, 41 N. Y., 235.* * * * This statement of the rights and obligations of the parties has been generally followed in other cases in which similar questions have arisen, and stockboards and brokers have adopted it as correctly stating the nature of the relation between broker and customer."

The United States District Court for the Eastern District of Virginia has also followed the doctrine of *Markham* v. *Jaudon,* in *Re Bolling,* 147 Fed. Rep., 786, where much stress is laid upon the opinion of Mr. Justice Prentice in *Skiff* v. *Stoddard, supra.*

While this court has never directly passed upon the question, it is nevertheless believed that it has impliedly recognized the New York rule in *Galigher* v. *Jones, 129 U. S., 193.* There a stockholder who had purchased shares for a customer on margin, received orders by telegraph from his principal to sell these securities, which are described in the opinion as belonging to the principal in his hands, and to invest the proceeds in certain other securities named in the order, at a fixed limit. At the time when this order was received, the principal was indebted to the agent for advances, commissions and interest, for about $4,000 more than the value of the securities in his hands. The broker did not execute the order, did not notify the principal by telegraph that he

declined to do so, and made no demand for further advances, but notified him of his refusal by letter written on the day when the order was received, which reached the principal two days later. The securities which had been ordered sold depreciated below the prices at which they could have been sold on that day, and those which had been ordered bought advanced so that they could have been sold at a large profit. The broker sued the principal for advances on an open account current and interest and commissions. The principal set up as a counterclaim the losses occasioned by the facts stated. It was held that the broker was liable for all the damages which the principal sustained by the refusal to change the stocks, both on the stocks ordered sold and those ordered purchased.

It seems to follow logically from this decision, if it had not been assumed that the title to the shares held by the broker was in the customer, that a different conclusion would have been reached; that it would have been entirely optional with the broker to have entered into new contractual relations with his customer, such as would have been involved if the customer had merely entered into an executory contract for the purchase of shares, through or with the broker.

In determining the rule of damage, this court followed the rule prevailing in New York, Mr. Justice Bradley pertinently saying:

"Perhaps more transactions of this kind arise in the State of New York than in all other parts of the country."

This suggestion is equally potent, when directed to the proposition, as to whether or not the rule

for which the respondents here contend, should be applied, rather than what is conceived to be the so-called Massachusetts rule.

In *Crawford* v. *Burke, 195 U. S., 176, 194,* the New York doctrine was also inferentially recognized, Mr. Justice Brown saying:

"In the case under consideration defendants purchased, under the instructions of the plaintiff, certain stocks and opened an account with him, charging him with commission and interest and crediting him with amounts received as margins. Subsequently, and without the knowledge of the plaintiff, they sold these stocks, *and thereby converted them to their own use.* Without going into the details of the facts, it is evident that the plaintiff might have sued them in an action on contract, charging them with the money advanced and with the value of the stock; *or in an action of trover based upon their conversion.*"

Obviously, there could be no action for conversion unless the title to the stocks was in the customer.

It appears from the *Commercial and Financial Chronicle,* that the total number of shares dealt in on the New York Stock Exchange during the past eight years, has been 1,675,768,925, or an average during each of these years of 209,471,113 shares. The great bulk of these transactions have been on the margin basis. These figures do not include the transactions on the New York Consolidated Stock Exchange or on the Curb, or the infinite number of dealings in mining and other shares, which are not listed on either of the stock exchanges.

Ever since the decision in *Markham* v. *Jaudon,* in 1869, the rule declared in that case has governed in transactions of like character, the aggregate

amount of which during the past forty years staggers the imagination. The entire stock brokerage business in New York City is conducted according to that rule. All brokers have adjusted their methods of business upon it. They depend for their security in large measure upon its enforcement. They have entered into contracts involving huge amounts in reliance upon it. A change or modification in this rule at this late day would create chaos and confusion, and would tend to impair the obligations of innumerable contracts.

It is equally true with regard to the purchasers of shares of stock, that the establishment of a new rule would be productive of serious injury, would in many instances result in a deprivation of the purchaser of shares of stock, on margin, of an effective remedy, and would leave him at the mercy of brokers, who might snap their fingers at an action based on the theory of a breach of contract, but who would hesitate to subject themselves to the consequences of an action based on the theory of conversion.

It is not claimed that a contrary rule has been established in any State other than Massachusetts; but, on the other hand, California, Connecticut, Illinois, Maryland and Pennsylvania have adopted it. In practice it has been followed in many of the other States, in which transactions of this character are common. Hence, in the great commercial centres of New York, Philadelphia, Chicago, Baltimore and San Francisco, stocks are bought, on margin, under a rule established by the highest State courts governing those localities, which is now sought to be superseded by an entirely different rule, admittedly bearing in its train a host of complications, and likely to lead to

such a degree of uncertainty, as cannot result otherwise than in a prostration of business interests.

The rule of *Markham* v. *Jaudon* is recognized by all of the text writers, as appears from the opinion of Mr. Justice Prentice in *Skiff* v. *Stoddard, supra.*

Nowhere is the subject more satisfactorily discussed than in *1 Dos Passos on Stockbrokers and Stock Exchanges, Second Edition, pp. 179-200.* At page 196 he says, after considering the various authorities, including the Massachusetts cases:

"Upon the whole, while it must be conceded that there are apparently some incongruous features in the relation, there seems to be neither difficulty nor hardship in holding that a stockbroker is a pledgee; for, although it is true that he may advance all or the greater part of the money embraced in the speculation, if he acts honestly, faithfully and prudently, the entire risk is upon the client, and may be enforced against him as a personal liability, irrespective of the value of the securities, which are the subject of the transaction. To introduce a different rule would give opportunities for sharp practices and frauds, which the law should not invite; and if it be true, as Mr. Justice Woodruff puts it (in Markham *v.* Jaudon, dissenting opinion) that 'the transaction is an executory agreement for a pure speculation in the rise and fall of stock, which the broker, on condition of perfect indemnity against loss, agrees to carry through in his own name and on his own means,' accounting to the client for the profits, it is very questionable whether all the transactions of Wall Street could not be set aside as mere wagers. But, as we have seen, the cases most emphatically condemn this view."

As has been said, Massachusetts stands practically alone in this country, in support of a con-

trary doctrine, it being there held that, in a transaction of this nature, the broker and customer are merely parties to an executory contract, the customer purchasing the right to have delivered to him specific stocks on the payment of an agreed price, or to have them carried for him and disposed of at his order.

Under this rule, the actual intention of the parties seems to be lost sight of. In reality, the broker intends to risk nothing, and to sustain a loss only, if the securities are worth less than the amount advanced upon them and the customer is pecuniarily irresponsible.

Under the Massachusetts rule, the broker, who has no interest in the speculation beyond receiving a moderate commission, is compelled to become the owner of stock which he does not desire to purchase, but which his customer seeks to acquire; and although treated as the owner, the broker is nevertheless required to credit the customer with the dividends received upon the stock.

As was said by Mr. Justice Prentice in *Skiff* v. *Stoddard, supra*:

"The fundamental difficulty grows out of the necessary attempt in some way to transform the customer, who enjoys all the incidents and assumes all the risks of ownership, into a person who in fact has no right, title or interest, and to create out of the broker, who enjoys none of the incidents of ownership, and assumes not a particle of its responsibility, a person clothed with a full title and an absolute ownership."

The first Massachusetts case in which a doctrine contrary to the New York doctrine is claimed to have been established, is *Wood* v. *Hayes, 15 Gray, 375;* but the decision there reached, did not con-

travene the doctrine for which we contend, although the opinion, which is extremely brief, is possibly open to the interpretation which has been to it in later cases.

There a broker bought stock for another, with money all of which was advanced by himself. He pledged it as security for his own debt to a third person. The customer did not pay or tender the amount of the advances. It was held that, in the absence of such payment or tender, no cause of action had accrued against the broker in favor of the customer.

In the subsequent case of *Covell* v. *Loud, 135 Mass., 41,* a broker agreed to buy and hold certain shares of stock for a customer, who paid a part of the purchase money, agreeing to pay interest on the sums advanced by the broker, and in case the stock depreciated in value, to pay margins of a certain sum per share in excess of the market price. The opinion shows that when the customer was called on to make good his margin by advancing the necessary sums, he told the brokers that he could pay them no more, and to do the best that they could for him. They thereupon sold the stock at the Brokers' Board, without notice to the customer. Mr. Justice Devens, commenting on this fact, said:

"This was sufficient to give them authority to sell the stock, if in so doing they acted fairly, and with proper regard to the interests of the plaintiff. Nothing appears tending to show that they acted otherwise."

It is true that *Wood* v. *Hayes, supra,* was cited in contrast with *Markham v. Jaudon, supra,* but it was not necessary for the decision to lay down

any rule as to whether or not the relation of pledgor and pledgee existed between the parties.

In *Weston* v. *Jordan, 168 Mass., 401,* Jordan bought stock through Wheatland, a broker, who subsequently made an assignment to Weston. Jordan paid part of the purchase price as margin, and Wheatland undertook to carry the stock, but failed to keep it, or any stock of the same kind, in his hands, and was unable and refused to deliver the shares on demand. The broker subsequently on receipt of the balance of the purchase price went into the market and purchased the shares which he delivered to Jordan.

The court declined to consider how far Massachusetts was committed to a rule different from that adopted in New York, Mr. Justice Allen saying:

"The defendants seeks to have these decisions reconsidered, but the facts of the present case do not call for such reconsideration of the several doctrines. Even if at the outset Jordan were to be declared a pledgor, with Wheatland a pledgee, of the shares, that relation was changed by what happened afterwards. * * *"

"After Wheatland had parted with the control of the shares, and after repeated demands for them by Jordan, and refusals by Wheatland to deliver them, Jordan had a valid ground of action against Wheatland, either for breach of contract or for a conversion; *it matters not which.*"

In *Chase* v. *Boston, 180 Mass., 458,* the question arose as to whether or not a broker who held shares of stock in his own name, and which he carried for his customers on margin, was required to pay a municipal tax upon their value. It was held that he was.

But that decision could be sustained without in any way affecting the question which would arise as to the relative rights of the customer and broker as between themselves.

It is evident that the learned court was in serious doubt as to the views entertained, for Mr. Justice Holmes said:

"No doubt, whichever view be taken, there will be anomalies, and no doubt it is possible to read into either a sufficient number of implied understandings to make it consistent with itself. Purchases on margin certainly retain some of the characteristics of ordinary single purchases by an agent, out of which they grew. The broker buys and is expected to buy stock from third persons to the amount of the order. *Rothschild* v. *Brookman, 5 Bligh (N. R.), 165; Taussig* v. *Hart, 58 N. Y., 425.* He charges his customer a commission. He credits him with dividends and charges him with assessments on stock. However the transaction is closed, the profit or loss is the customer's. But none of these features is decisive."

In *Rice* v. *Winslow, 180 Mass., 500,* a customer sued the broker for money and securities which he had delivered as a margin, claiming to recover under a statute which condemned certain transactions as gaming contracts. The decision merely involved an interpretation of the statute.

One of the sections of the statute provided:

"That whoever contracts to buy or sell securities on credit or margin, having at the time no intention to perform by actual receipt or delivery and payment of the price, may recover from the other party to the contract any payment made, or the value of anything delivered, provided such other party had reasonable cause to believe that no intention to actually perform existed."

A broker was employed to purchase securities and carry them on a specific margin for a principal, the latter to safeguard the broker against loss by keeping the margin good. The principal understood that the broker actually bought the securities, and that the broker would actually sell them when ordered so to do. It was held that the statute did not invalidate the contract, though the principal did not intend to pay for the securities or to take possession of them, since the principal did not buy of the broker. Judge Loring said:

"The contract which the statute refers to, when it provides that the securities are to be actually received and delivered, is the contract to buy, not the contract to carry. The contract to carry is actually performed where the securities are actually delivered to a purchaser under an order to sell from the customer; and that contract is no more actually performed when the securities are eventually paid for by the customer and delivered to him than when they are eventually delivered to a purchaser from the principal acting by his agent, the broker.'

In *Chase* v. *Boston* (*supra*), Mr. Chief Justice Holmes referred to *Bentwick* v. *London Joint-Stock Bank, 2 Ch. Div., 1893* (*120*), as indicating that the courts of Massachusetts were "not left quite alone in a desert of logic."

In that case it was however proven, that by a usage of the London Stock Exchange of long duration, a method of business known as the "contango" system had existed, whereby the broker was regarded as the outright owner of the shares, and the court having found the existence of such a custom, applied it.

In this country, however, the general custom has been, to regard the relations between the broker

and the customer in the case of dealings on margin, as that of pledgee and pledgor.

In re Swift 112 Fed Rep., 315, merely involved the question as to whether the customer of a Boston stockbroker for whom the latter had carried stocks on margin, and who failed to receive the shares purchased by the broker, had a provable claim in bankruptcy for the damages sustained by him by reason of the non-delivery.

II.

Even if the Massachusetts rule were applied, it is urged that the respondents were entitled, on payment of the unpaid purchase money, to require a delivery of the shares of stock which Brown was carrying for them, and which he had on hand at the time when the amount owing by the respondents was tendered, and the delivery of the shares was demanded, especially in view of Brown's insolvency.

In making delivery of the shares to the respondents, Brown was merely doing what a court of equity might have required him to do, under the circumstances. A contract had been entered into for the purchase of specific shares. A substantial part payment of the purchase price had been made by the respondents. The shares were under Brown's control. He was bound to deliver them

on the payment of the remainder of the purchase price, and he was in a position which enabled him to make delivery on such payment. The shares were ear-marked. It would have been highly inequitable for Brown to have withheld the shares, especially since an action for damages would have been fruitless. Hence, on the facts, the respondents would have been entitled to a decree for specific performance, even as against the interposition of the statute of frauds.

In *Johnson* v. *Brooks, 93 N. Y., 337,* which was an action to enforce the specific performance of a contract to deliver shares of stock and bonds of a mining company, the purchase price of which had been paid by the plaintiff, Judge Danforth said:

"The plaintiff's money was advanced for investment in a mode specified, and the stock and bonds were to be allotted and delivered when the investment was made. The defendant undertook to act in the interest of the plaintiff and thereby assumed toward him a fiduciary relation, from the obligation of which the statute cited offers no immunity, and the enforcement of which is the peculiar province of a court of equity. Moreover, the contract, although not in writing, was susceptible of a part performance, and was performed by the plaintiff; he advanced, and the defendant received, the money which formed the consideration of his undertaking, and which indeed he has also partly executed by procuring the stock and bonds in question; there is no reason, therefore, why he should not fully execute the agreement by delivering over the stock and bonds to the plaintiff, for whose benefit they were procured. (*Stanton* v. *Percival, 5 H. L. Cas., 257; Cowles* v. *Whitman, 10 Conn., 121; Kimball* v. *Morton, 1 Halst. Ch., 26.*) It is true the plaintiff has no title to specific shares which he could assert at law, but that only furnishes an additional reason for asking equitable relief."

In *Todd* v. *Taft, 7 Allen, 371,* a bill in equity was maintained for the specific performance of an agreement to transfer shares of a corporation upon the payment at maturity of a note given for the price thereof. The bill alleged that on May 1, 1860, the defendant, being the owner of fifty shares of the stock of the Providence & Worcester Railroad Company, in consideration of $250 paid to him by the plaintiff and a promissory note for $4,750, agreed on the payment of the note to transfer the stock to one Farnum or his order. The agreement was at once transferred by Farnum to the plaintiff, for whose benefit Farnum was acting. The plaintiff tendered the full amount of the note with interest, which the defendant refused to accept. Mr. Justice Dewey said:

"Upon the facts shown in the present case, we see no difficulty in the plaintiff's enforcing under this bill in equity all the rights that could have been enforced by Farnum had the interest in the contract been vested solely in him. * * *

The case is not that which would have been presented if Farnum had simply secured by the payment of a given sum of money the right to become the purchaser of fifty shares of Providence & Worcester Railroad stock, the right to be exercised or not, at his election, and to be attended with no forfeiture or liability, other than a liability to the loss of the sum paid for the right to purchase, if the state of the market at the day named made it for his interest not to complete the purchase."

See also

2 Story's Eq. Jur., § 728.
8 Pomeroy's Eq. Jur., §1402.
Stuyvesant v. *Mayor, 11 Paige, 414.*

Storer v. *Great Western Ry. Co., 2 Young & Coll., 48.*
Wilson v. *Furness Ry. Co., L. R., 9 Eq., 28.*
Express Co. v. *Railroad Co.*, 99 U. S., *200.*
Williams v. *Montgomery, 148 N. Y., 527.*
Butler v. *Wright, 186 N. Y., 261.*
New England Trust Co. v. *Abbott, 162 Mass., 148.*

A trustee in bankruptcy has no better title to property coming into his hands, or disposed of by the bankrupt before the adjudication than the bankrupt, and even where property of which the bankrupt has the nominal title comes into his hands, he takes it subject to all equities, liens or encumbrances, whether created by operation of law or by act of the bankrupt, which were available as against the bankrupt, except in the cases of levies, judgments, attachments or other judicial liens created against property within four months preceding the commencement of the proceedings in bankruptcy, and except also in cases where a disposition of property by the bankrupt is declared by law to be fraudulent and void.

Loveland on Bankruptcy, 3d Ed., 439.
Yeatman v. *Savings Inst., 95 U. S., 764.*
Metcalf v. *Barker, 187 U. S., 165.*
Hewitt v. *Vernon Machine Works, 194 U. S., 296.*
Thompson v. *Fairbanks, 196 U. S., 516.*
Humphrey v. *Tatman, 198 U. S., 91.*

As was said by Mr. Justice Peckham in *Thompson* v. *Fairbanks, supra*:

"Under the present bankrupt act, the trustee takes the property of the bankrupt in cases unaffected by fraud, in the same plight and condition that the bankrupt himself had it and subject to all the equities impressed upon it in the hands of the bankrupt, except in cases where there has been a conveyance or encumbrance of the property which is void as against the trustee by some positive provision of the act."

In that case the rule was applied to the enforcement of a lien on after-acquired property, by the holder of a valid chattel mortgage who took possession with the consent of the mortgagor, and this was held not to be a conveyance or transfer under the Bankrupt Act.

Here it may with equal justice be claimed that the respondents being equitably entitled to insist upon performance by Brown of his contract, to deliver the shares of stock, for which the respondents had paid in part, he had the right to making delivery on receiving the unpaid balance of the purchase price.

III.

The withdrawal by the respondents of $5,000 on June 24, 1903, was not a preference.

The agreement between the parties was that the respondents should maintain a margin of ten

per cent. On June 24th, when they withdrew $5,000, their margin was about thirty-three and one-third per cent. (Rec., p. 18). By the withdrawal of margin, they increased their indebtedness to the bankrupt, and when they closed the account two days later, they were obliged to pay precisely $5,000 more to gain possession of their stocks, than they would have had to pay if the margin had been maintained without diminution.

The $5,000 withdrawn from the bankrupt, being a sum in excess of the agreed margin, was not a debt owing by the bankrupt to the respondents. Payment of that sum therefore was not the payment of a debt. On the contrary, as has already been pointed out, it was the respondents who were indebted to the bankrupt. As security for this indebtedness the bankrupt held the stocks purchased for them. When the latter withdrew $5,000 margin, they simply exercised one of their rights under the agreement, which was that the margin should at all times equal ten per cent. of the market price of the stocks from time to time, according to their fluctuations. At the time of the withdrawal the margin was more than three times the agreed percentage. While the respondents by the withdrawal increased their indebtedness to the bankrupt, his estate was not depleted, because the stocks in his hands were adequate security for the difference between the purchase price and the amount of margin remaining.

If a watch worth $100 were pawned for a debt of $25 and afterwards the pledgor, knowing the pledgee to be insolvent, should obtain a further advance of $25 upon the same security, no one would assert that that was a preference. The watch being adequate security for the whole debt,

the creditors of the pledgee could not be harmed; and the result would be the same if the additional loan upon the watch increased the aggregate debt to the exact amount of the value of the watch. So, too, if the pledgor knowing the pledgee to be insolvent, should redeem the watch, paying the whole debt, it could not be contended that the transaction was a preference.

The withdrawal of the $5,000 on June 24th and the closing of the account on June 26th, should be regarded as one transaction.

These views are equally pertinent whether the rights and relations of the parties be deemed governed by the law as applied in New York or by the doctrine established in Massachusetts, or whether the broker be deemed merely "a creditor holding security." (*Opinion of Judge Holt, Rec., p. 25*).

As was said by the learned Trial Judge, referring to the $5,000 transaction:

"Now, with respect to this payment of five thousand dollars, Mr. Leavitt has argued very ingeniously that Shaw & Company had made money in their speculations and were entitled to it and were not obliged to keep it there as margin; but the truth is, in my opinion, it was not paid as a debt. There was no debt existing at that time. The debt was from the customer to the broker, and it was a case simply where a creditor has such large collateral, or securities so much in excess of the debt, that he was willing to increase the debt. It was an advance, in my opinion, from the broker to the customer to be ultimately settled when the account was closed with the customer. If he had not advanced the five thousand dollars, he could have got the securities by paying twenty-nine thousand dollars, and it may be called a partial settlement, or, more

properly, an advance on the general account" (*Rec., p. 26*).

IV.

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed with costs.

LOUIS MARSHALL,
Respondents' Counsel.

Supreme Court of the United States.

HENRY ARNOLD RICHARDSON, as Trustee in Bankruptcy of J. FRANCIS BROWN,
Plaintiff-in-Error,

against

JOHN M. SHAW and ALEXANDER DAVIDSON,
Defendants-in-Error.

Respondents' Brief

Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

Statement.

A Trustee in Bankruptcy brings action to recover certain alleged preferences. The Trial Court directed the jury to return a verdict for the defendants, for the expressed reason that the plaintiff had made out no case of preference. The Circuit Court of Appeals for the Second Circuit, in a terse opinion written by Coxe, Circuit Judge, and concurred in by Judges Wallace and Lacombe, affirmed the judgment of the Trial Court. The luminous opinion of District Judge Holt, the Trial Judge, is reported with the opinion of Judge Coxe, 147 Federal Reporter, pages 659-665 (pages 24-26 and 43-47 Transcript). From the record, the salient and uncontroverted facts are:

J. Francis Brown, the Insolvent, was a stockbroker

transacting business in Boston. The Respondents, John M. Shaw and Alexander Davidson, partners and stockbrokers, transacted business in New York. The Respondents had many transactions with Brown, from February to June, 1903, of purchase and sale of stocks for the account of the Respondents. The account was carried in Brown's books in the name of "Royal B. Young, Attorney," as agent for Respondents. The transactions were conducted in Boston, by mail and wire from New York. Respondents deposited margins with Brown, from time to time, on account of the purchase or selling price, of the stocks which they ordered bought or sold. These margins were either money or securities, and were contemplated by market custom to be at least ten per cent. of the value of stocks sold and purchased, and in these transactions at times largely exceeded ten per cent. By special agreement between the parties (pages 24, 35, 41 Transcript), and the undisputed market custom, all stocks and securities so purchased by Brown, might be by him pledged *en bloc* for amount of purchase price, or as security for his general borrowing or loan accounts, and might be bought or sold at public or private sale without notice, if Brown deemed such sale or purchase necessary for his protection. Dividends on the securities were credited from time to time to the Respondents. Respondents were charged with interest on the gross amount of purchase price, and credited with interest on margins deposited (pages 20, 29, 30, 31 Transcript, Ex. 4). If at any time the total amount of margins in security or money exceeded 10%, the Respondents had the right to withdraw the excess.

The Insolvent, Brown, transacted much of his general loan business with Brown, Riley & Co. of Boston, the Brown of that firm being a brother of the Insolvent. The Insolvent pledged his general securities with Brown, Riley & Co. On June 24, 1903, the Insolvent had on deposit with Brown, Riley & Co. as a pledge for loans, used for pur-

chase price, most of the stock and securities were... been purchased for and treated by the parties as the property of the Respondents. On June 24, 1903, Young, the agent of Respondents, doubtless being fearful of the solvency of Brown, demanded a settlement of Brown's agent, Fletcher. At that time the margin already paid by Respondents exceeded the agreed ten per cent., and preliminary to the general settlement which took place two days later, Fletcher returned to the Respondents five thousand dollars of such margin.

On June 26th, 1903, an account of the transactions was stated between the parties. It was found that the Respondents owed Brown $34,919.62, and Brown held stocks therefor, which on that day had a market value of $45,583.75. This balance against Respondents was obtained as a result of the various credits and charges during the months the account had run, for margins deposited and withdrawn, advances by Brown for purchase price with interest, interest allowed on margins, dividends, commissions, etc. This was taking into consideration, the withdrawal of $5,000 in margins, June 24th, 1903. On that date, Respondents would have been compelled to pay Insolvent only $29,919.62 to demand and receive delivery of their stocks, but having withdrawn $5,000 balance to their credit as margins, the amount of purchase price was increased to $34,919.62.

On June 26, 1903, the stocks had been pledged by the prospective bankrupt to Brown, Riley & Co. This with the exception of a small portion pledged with two banks as collateral. The Respondents' agent Young agreed with Fletcher, Brown's agent, that the account should be closed. He recognized that their mutual dealings gave Respondents the right to receive the stock on hand by paying balance due. An important fact is conceded, that Brown had the stocks at his demand which he had purchased for his principal. Brown, it is true, had repledged them to

Brown, Riley & Co. and two banks, but this by express agreement with Respondents. Fletcher immediately proceeded to collect the stocks. A small portion was with two banks, and Fletcher secured them by depositing with the banks other stock in lieu thereof. The bulk of the stock and securities were pledged to Brown, Riley & Co. The Insolvent had deposited with Brown, Riley & Co. as margins, $10,000. In addition to this he gave his check for $1,200 and the note of a third person held by or procured by the Insolvent for $5,000. It does not appear what additional stocks had been pledged by the Insolvent with Brown, Riley & Co.; but it required the appropriation of the check for $1,200, the note of $5,000, his margin of $10,000 and the check of the Respondents for $34,919.62 (made out for convenience to Brown, Riley & Co.) in order to return to Respondents their stocks. This closed the transactions. Brown made an assignment the next day and was adjudicated bankrupt within four months.

On these facts petitioner, as Trustee in Bankruptcy, brought action in the District Court for the Southern District of New York. The complaint contains two causes of action. The first cause is to recover the $5,000 repaid June 24, 1903, to Respondents as excessive margins. The complaint charges the payment to have been made to enable Respondents to obtain a preference as Creditor of the Insolvent. The second cause of action briefly states Respondents as debtors to the Insolvent for $34,919.62 and that upon the payment of the DEBT, the Insolvent "was obligated to deliver to Respondents certain securities or in default of such delivery to pay the difference between their *then* ascertained value and the amount due to Insolvent of $34,919.62, viz., $10,664.13." It is charged that Respondents paid their debt and received the securities, and that such transaction constituted a preference.

Petitioner Contends:

(*a*) That Respondents were creditors of the Insolvent, because the transactions between them were a series of executory contracts. That these executory contracts obligated the broker to deliver on demand to the customer certain specified stocks at a price certain. If the contract remained executory until the broker became insolvent, he created a preference if he executed the contract by delivering stocks of a then market value greater than the price which the customer had agreed to pay, and greater than the debt due by the customer. By the same reasoning, he contends, if the contract being executory and the broker insolvent, and the stocks depreciated in value since their purchase, an honest customer being willing to pay the purchase price, the broker COULD lawfully execute the contract.

(*b*) That the transaction is to be judged by the Court-made law of Massachusetts where the transaction took place. He contends the Federal Courts of Bankruptcy in New York or Massachusetts or elsewhere must ascertain who are creditors or debtors of the bankrupt, as defined by the State Statutes, and the law enunciated by the State Courts, of the bankrupt's residence, if the transaction complained of took place there. If the bankrupt engaged in and performed a contract with one person, in New York and exactly the same character of transaction with another person in Massachusetts, the Federal Court of Bankruptcy might and should regard one transaction as an unlawful preference, and the other a lawful payment, in obedience to the opinions of State Courts, which might radically differ.

(*c*) He insists the opinions of the learned Judges of Massachusetts defining the relations between Broker and Customer on marginal accounts, made Respondents credi-

tors of the bankrupt. In one instance he states, the "anomalies" and "inconsistencies" of the law as defined for many years and by numerous learned Judges of New York make the Customer a debtor of the Broker, and immediately insists that if the New York Court law be regarded as presenting a correct theory of the relations between the parties, the theory is "ragged," and the status of the customer is that of Creditor and not Debtor. He admits that in this case the difference between the New York and Massachusetts view is academic.

(*d*) And not being able to reconcile these conflicting positions, he argues with ingenious sophistry, that to have harmony we must regard Broker and Customer as engaged in joint adventures, in which the Broker obtains a commission and the Customer a loss or profit, all out of margins and broker's advances.

Respondents Contend:

(*a*) The New York rule and the Massachusetts rule defines the relation between Broker and Customer, upon the basis of their dealings, in the absence of a specific agreement defining those relations. One rule declares the Broker an agent for his principal, the Customer. He purchases for the Customer, stocks and securities. He holds the purchased property as pledgee for the Customer pledgor, for his advances. The Customer owns the stocks. The Customer is the Debtor and the Broker the Creditor, and this relation does not change because the pledged stock may alter in value from day to day, to a value greater or less than the amount of the original debt. The Massachusetts rule declares the contracts executory and that the title remains in the Broker. In the case at bar we insist the parties impliedly, if not expressly, recognized and adopted the New York Rule from the time they commenced their dealings until the transactions were closed in full

accord with the New York Rule. On all their statements was printed their agreement. This agreement was inconsistent with any belief that the broker owned the stock, otherwise, why this agreement?

> "It is understood and agreed that all securities carried in this account or deposited to secure the same may be carried in our general loans and may be sold or bought at public or private sale without notice, when any sale or purchase is deemed necessary by us for our protection."

(Exhibits 1, 2, 4, 5, 10, pages 27, 28, 29, 35, 41.)

(*b*) The New York Rule defining the rights and relations of Broker and Customer should be declared to control the Federal Courts in cases of this character. The Broker is the agent, the Customer the principal. He buys stocks for the principal who owns them, and owes for them. The Broker retains them as a pledge for his advances.

(*c*) Whether the New York or Massachusetts Rule be adopted here, the contract being uncompleted, and neither party refusing to perform, the Customer paying the balance of purchase price, completing the purchase and receiving the stock, did not thereby receive a preference. The Broker owed him no debt, and delivered no property, by which he preferred the Customer as a creditor. Under the Massachusetts Rule, it must be conceded that the Customer has an equitable interest in the stock. When the creditor of a bankrupt has an equitable estate in property held by the Insolvent, created before the insolvency or knowledge of insolvency, the parties may define the rights of the creditor in the property, even at a time when the debtor is known to be insolvent, and such definition will not be a preference.

(*d*) The withdrawal of $5,000 on June 24, 1903, by the Customer was only a part of the final adjustment of June 26, 1903, when the contract was closed. The Broker agent

had agreed, as a part of the contract with his principal, the Customer, that margins deposited in excess of ten per cent. might be withdrawn. If there was an unlawful preference—it was one preference. If A agrees with B to loan B five thousand dollars, and pays him on the loan half the sum in the morning and half in the afternoon, a default by B would constitute one cause, not two causes of action.

The New York Rule.

We respectfully submit that if this case seems to demand a decision by this Court, of the rule which is to control the Federal Courts of the United States in defining the relations, rights and liabilities of brokers and customers, in transactions relating to the purchase and sale of stocks on margin, that it will be to the interest of the great commercial public that the New York Rule be adopted. We suggest the following reasons:

(*a*) The New York Rule has been long settled and steadily adhered to. It has practically become a rule of property in most of the States. It has been followed by the Courts of the State of New York from the time of the decision in Markham vs. Jaudon, 41 N. Y. 235, in the following cases:

Stewart vs. Drake, 46 N. Y. 449.
Stenton vs. Jerome, 54 N. Y. 480.
Baker vs. Drake, 66 N. Y. 518.
Gruman vs. Smith, 81 N. Y. 25.
Capron vs. Thompson, 86 N. Y. 418.
Caswell vs. Putnam, 120 N. Y. 154.
Gillette vs. Whiting, 120 N. Y. 402; 141 N. Y. 73.
Minor vs. Beveridge, 141 N. Y. 399.
Hurd vs. Taylor, 181 N. Y. 231.
Content vs. Banner, 184 N. Y. 121.

The rule has been adopted in many other States.

Child vs. Hugg, 41 Cal. 519.
Thompson vs. Toland, 48 Cal. 98-99.
Cashman vs. Root, 89 Cal. 373.
Skiff vs. Stoddard, 63 Con. 198.
Brewster vs. Van Liew, 119 Ill. 554.
Maryland Life Insurance Co. vs. Dalrymple, 25 Md. 242 and 269.
Wynkoop vs. Seal, 64 Penn. State 361.
Esser vs. Linderman, 771 Penn. State 76

The rule was rejected in Massachusetts by its then Chief Justice Holmes, in the case of Chase vs. Boston, 180 Mass. 458, by what must be conceded to be a clear and soundly reasoned opinion. We respectfully submit that the reader of the opinion will be forced to the conclusion, that the Chief Justice followed the ruling of an English Court, and affirmed the former opinions of the Massachusetts Courts, animated at least to some extent, by the belief that it had become a rule of property in Massachusetts, and inasmuch as the rule had been so established, it was inexpedient to depart from it unless it could be shown that a grave error had been committed in adopting such a rule.

It is clear that both the New York Rule and the Massachusetts Rule, as counsel for petitioner has so ingeniously argued, if applied in certain given cases will produce illogical results and irreconcilable positions. The Courts of Illinois, Pennsylvania, Massachusetts and New York are called upon to decide nearly all of these cases which arise in the United States, because Chicago, Philadelphia, New York and Boston are the great markets for stock transactions. The Courts of three of these States have uniformly and consistently maintained the proposition that as between broker and customer, the equitable, if not the legal title, to the stocks purchased on margin is in the customer and the broker holds them as pledgee. They hold that the broker is the agent and the customer is the principal. They hold that the broker keeps possession of the stocks as a pledge to secure him for his advances on the

purchase price. They hold the earnings of the property, viz.: the dividends, go to the owner, the customer. They hold that the customer's rights and ownership of the stock cannot be terminated or finally sold unless upon due notice or by the express terms of the written contract, or the customs and usages attending such contracts between broker and customer. They hold that this is not necessarily inconsistent with the right of the broker to re-pledge the securities in his general loan. The result of these rulings is that the customer is not a creditor or a debtor, except, perhaps, when the parties on the one side or the other refuse to carry out the contract.

It becomes every day more evident that the growing and complex business conditions of the great commercial life of this country demand a uniformity of rulings by the Federal and State Courts upon questions in the law-merchant, and new questions arising from new commercial conditions.

It is respectfully submitted that for this Court to give its approval on the question involved here to the decision of the Courts of Pennsylvania, New York and Illinois, and against the Courts of Massachusetts will be another step in the direction of uniformity.

New York Rule Adopted by the Parties.

Printed on the statement rendered, the parties (Pages Transcript 27, 28, 29, 35) announced the conditions upon which they would deal. Is it not apparent by the language, that they contemplated their business should be done under the New York Rule and that the Respondents owned the stocks, viz.:

> "It is understood and agreed that all securities car-
> "ried in this account or deposited to secure the same
> "may be carried in our general loans and may be sold
> "or bought at public or private sale without notice,
> "when such sale or purchase is deemed necessary by
> "us for our protection."

The facts accentuate this understanding of ownership. It is admitted that the dividends or earnings of the property were credited to the purchasers (Respondents). The Respondents were charged interest on the purchase price advances, and credited with interest on their margins, or advances on purchase price.

In holding (as the "New York" Rule does) that the customer has the proprietary interest in the securities purchased, and the broker merely a lien upon them for his advances, the Courts are simply carrying out the intent of the parties. The entire risk of the venture is the customer's. The broker, whenever necessary, may call for more margin, and realize upon the security if it is not forthcoming. It is impossible for him to lose except through his own carelessness. On the other hand, the profits of the venture, however great, belong wholly to the customer. All that the broker can possibly receive is his commission and the interest upon his advances. In these respects the present account is precisely like the thousands of other speculative accounts which are opened and closed every day. Fletcher testified:

> "If these stocks which we were carrying for John M. Shaw & Company made a profit, that profit belonged to Shaw over and above his balances; we didn't figure it as profit; everything belonged to Shaw over and above what he owed us."
>
> (Page 20, Transcript.)

To say, under such circumstances (as it is claimed that the Massachusetts cases do), that the broker owns the stock, but has contracted to sell it to the customer, violates the common sense of every man, in the stock market or out of it.

The alleged difficulties in the way of the "New York" Rule are more seeming than real. They are predicated principally upon the right of the broker—either through custom or express contract—to pledge the customer's securities in his own loans; and the fact that, for the same

reason, he is not required to retain the identical certificate purchased, but satisfies his obligation by keeping on hand, or under his control, a like amount of the stock.

(See Horton vs. Morgan, 19 N. Y. 170; Stewart vs. Drake, 46 N. Y. 449, 453; Caswell vs. Putnam, 120 N. Y. 153, 157.)

These circumstances, however, do not prove that the customer has not the proprietary interest in the stock, but merely that the pledgee has, by contract, a more extensive right to deal with the subject of the pledge than the law would otherwise allow him. If the features adverted to might (which we do not admit) lead to confusion in the attempt to apply, in other directions, the "pledge" theory, they do not in the present case. The securities have been identified and returned to the customer; and there is no reason whatever for saying that the latter did not receive them in the capacity of an owner who has paid off a charge upon his property.

There is no Preference, Even if but One Feature of the New York Rule is Adopted.

This feature is the theory—if that may be called a "theory" which is but the adoption of an uncontroverted fact—that, *as between themselves*, the customer, not the broker, has at all times the proprietary interest in the securities purchased. This is their agreement, the customer's right to claim them at any time being dependent merely upon payment of the advances made upon them. In New York, as has been seen, this right of property is held to be a legal one, enforceable in the legal action of trover. It would seem to follow that replevin would also lie; and here there is a practical difficulty, due to the broker's right to hold for the customer other certificates than the one purchased. It is difficulties such as these,

which are said to reflect upon the "New York" Rule. However that may be, the present case is not thus involved. Brown's agent, upon the Respondents' demand, got together, from property in his possession or under his control, securities of the kind and quantity bought for the Respondents or delivered by them as margin; and the only question is whether the Respondents rightfully received them. That question is not an open one.

In the case of Cook vs. Tullis, 18 Wall. 332, Homans, the bankrupt, was a banker, and had purchased for the defendant certain bonds upon his order. He took certain of these bonds, without permission, substituting other property therefor, and afterward took the latter, putting in their place a bond and mortgage belonging to himself. The defendant ratified these acts; and it was held that he thereupon became entitled to the last bond and mortgage, and that they could not be recovered from him by the trustees in bankruptcy of Homans. This Court said:

> "They (the plaintiffs) took the property of the bankrupt subject to all legal and equitable claims of others. *They were affected by all the equities which could be urged against him.* Now, it is a rule of equity jurisprudence, perfectly well settled and of universal application, that where property held upon any trust to keep, or use or invest it in a particular way, is misapplied by the trustee and converted into different property, or is sold and the proceeds are thus invested, the property may be followed wherever it can be traced through its transformations, and will be subject, when found in its new form, to the rights of the original owner or *cestui que trust*" (p. 341).

It is a well settled head of equity jurisprudence to remedy a fraud or breach of trust by tracing property wrongfully converted, and applying it, or its proceeds, in whatever form they may have taken, to the use of the person wronged.

Amer. Sugar Refining Co. vs. Fancher, 145 N. Y. 552.
Holmes vs. Gilman, 138 N. Y. 369.
Pennell vs. Deffell, 4 DeG., M. & G. 372.
In re Hallett, 13 Ch. Div. 696.
Cheney vs. Gleason, 117 Mass. 557.

The rights of innocent purchasers for value are, in such cases, of course regarded. Trustees in bankruptcy, however, do not come under this head; and still less does the Respondents' receipt of their property, within the four months and before the Petitioners' appointment, confer superior rights upon the latter or the creditors whom he represents.

Thompson vs. Fairbanks, 196 U. S. 516, 526, and cases cited.
In re Garcewich, 115 Fed. Rep. 87, 89.
Amer. Sugar Refining Co. vs. Fancher, 145 N. Y. 552, 560.

We need not go into the question whether the relations between stockbroker and customer are to be termed "fiduciary," so that, strictly speaking, trust questions are involved. Equity does not confine its jurisdiction to cases of strict trust, but intervenes to remedy mere fraud, where the law is powerless.

Amer. Sugar Refining Co. vs. Fancher, *supra*, pp. 558-9.

And even if this were otherwise, the only assignable reason why equity would not intervene in the case of stockbroker and customer would tend to show that the rights of the latter are of a legal character, which a court of law would be competent to protect. Thus a very learned Court has held, that, if a *del credere* factor sell goods of the principal, and take therefor notes, which are collected by the trustee in bankruptcy of the factor, *assumpsit* will lie to recover the moneys so received, on the theory that the notes never became the property of the factor.

Thompson vs. Perkins, 3 Mason 232—Circuit Court of Appeals, First Circuit—1823—Story and Davis, JJ.

But if the legal title to the securities in the present case was in the Respondents, the Petitioners' case is hopeless. He is upon the horns of a dilemma.

So far we have considered only the case of the securities purchased upon the Respondents' order, which is certainly the one most favorable for the Petitioners. To say that Brown acquired title to the stocks and bonds pledged as margin, seems an absurdity. It is a plain case of a special deposit for a specific purpose; and in case of misappropriation, equity would have entertained a bill to reach the property, or compel the bailee to respond in damages if it could not be reached.

Manhattan Bank vs. Walker, 130 U. S. 267, 371.

They did not lose their character as a pledge because Brown was authorized to do certain specific things with them, for none of these things was inconsistent with the Respondents' title, as between themselves and Brown. If someone to whom Brown had re-hypothecated the securities under the contract had wrongfully sold them, doubtless the Respondents would have had no right to complain. But the fact that they might thus lose their title is no evidence that they were not the owners, as between themselves and Brown. It would be as reasonable to argue that, because a pledgor of property may lose it through a conversion by the pledgee, *ergo*, there could not have been a pledge at all, but the pledgor must at the outset have parted with his proprietary interest. The substitution of one certificate for another has been sufficiently considered. In one case, as has been seen (that of the Shannon bonds), the plaintiff has not even this fact to fall back upon. How can it be sensibly argued that these bonds, deposited as security, and returned intact when the loan was paid, ever belonged to Brown? And yet, as has been seen, all of the

securities ever held by Brown—whether purchased for the Respondents, or pledged by them—whether represented by the original instrument, or by another—were all treated alike by him, and are now claimed to have all belonged to him (see Fletcher's testimony, folio 30, page 16). This is a *reductio ad absurdum.*

Finally, the task of the Court in this case is much simpler than in any of those cited. It is not required to decide whether it ought to make an affirmative effort, in the exercise of its equitable powers, to trace property of which the true owner has been deprived. The Respondents have received their own—that which was purchased upon their order, with moneys either furnished by themselves, or advanced to them for the very purpose of the purchase. Will this Court, looking at the completed transaction *with an equitable eye,* condemn their doing so? That is the true question; and we have no doubt of the answer that will be given to it.

The Transaction was not a Preference Under the New York Rule.

If the New York Rule is to be applied to the case it makes the plaintiff's recovery hopeless.

Sec. 60 of the Bankrupt Act (subd. "a") provides:

> "A person shall be deemed to have given a preference if, being insolvent, he has within four months before the filing of the petition, or after the filing of the petition and before the adjudication, procured or suffered a judgment to be entered against himself in favor of any person, or made a transfer of any of his property, and the effect of the enforcement of such judgment or transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class."

At least two things are essential, (*a*) the bankrupt must owe a debt; and (*b*) he must make a transfer "of *his* prop-

erty" to apply upon it. Here (under the "New York" Rule) there could not have been a debt, since Brown, being in the lawful possession of the defendants' property, transferred it to them upon their demand. He was never in default. The Act certainly does not require that the bankrupt shall commit a deliberate tort, or infer, contrary to the fact, that he has done so. But if there was a "debt," Brown did not transfer *his* property, but the Respondents', to apply upon it. This rule is not merely stated, but consistently applied, in New York, by holding the broker liable for a conversion where he sells stock of the customer without a proper notice and opportunity to redeem.

Wright vs. Bank of Metropolis, 110 N. Y. 237.
Gillett vs. Whiting, 120 N. Y. 402.
Content vs. Banner, 184 N. Y. 121, and many other cases.

Though the broker may sell the certificates purchased for the customer, so long as he retains other stock of the same character and sufficient in quantity, his liability attaches at once when he disposes of the latter.

Taussig vs. Hart, 58 N. Y. 429.

Massachusetts Rule Not Controlling.

The Petitioners' counsel contend that the contract between the Insolvent and Respondents is a Massachusetts contract. Therefore its construction must be in accordance with the rules announced by the Courts of that State. With due respect, this is a *non sequitur*. Here there is no question of the validity of the contract or of its construction by virtue of any local statute, and the question presented is one in the Law-Merchant. Cases Thompson vs. Fairbanks, 196 U. S. 516; Humphrey vs. Tatman, 198 U. S. 91, are not applicable. It is well settled in this Court, that it will apply its own view as to the common law and announce its own application to commercial re-

lations, which have been created out of the complex business conditions of these days. This Court in Railroad Co. vs. Lockwood, 17 Wall. 357, refuses to apply the New York rule, "that a common carrier may stipulate for exemption from liability for injuries caused by its own negligence." In that case the person injured signed a contract in New York, absolving the defendant from liability received from whatever cause while being transported by it.

The Court said (pp. 367-8):

> "On the question of General Commercial Law, the Federal Courts administering jurisdiction in New York had equal and co-ordinant jurisdiction with the Courts of that State."

In Myrick vs. Mich. Cent. R. R., 107 U. S. 102, the Court considered the contract for the carriage of goods made in Illinois. The Court refused to follow the decisions of the Supreme Court of Illinois relating to like contracts. The Court stated that it was not a question of local law upon which the decisions of the State Court must control.

> "It is a matter of general law upon which this Court will exercise its own judgment. If we are to follow in this subject, the rulings of the State Courts, we would be obliged to give a different interpretation of the same act in different States, holding it to imply one thing in Illinois and another in Massachusetts" (pp. 109-10).

In Liverpool Steam Co. vs. Phoenix Ins. Co., 129 U. S. 397-443, this Court declined to be bound by the decisions of the Courts of the State of New York, and in fact states:

> "That any question dependent upon mercantile law, and not upon local statute, must be decided by the Courts of the United States, without being bound by the decisions of the Courts of the State, and this even when their jurisdiction attaches only by reason of

diverse citizenship, and upon a contract made and to be performed within the State."

In Washburn & Moen Manfg. Co., vs. Reliance Ins. Co., 179 U. S. 1, 15, the Court refused to apply the Massachusetts rules of construction to a Massachusetts contract.

It follows that the respective rights and liabilities of the Insolvent and the Respondents arising from their transactions would, in a proceeding in the Federal Courts, not necessarily be determined by the Massachusetts decisions; and this proposition seems more forceful where the ultimate solution of the question presented depends upon its relation to the terms of an act of Congress, viz., the Bankrupt Act, as to which the judgment of this Court is paramount. This is peculiarly a case for an authoritative ruling by this Court. Otherwise, unfortunate results pointed out by the Court in its opinion in Myrick vs. Mich. Cent. R. R. Co., *supra*, might follow in an extreme form, and the same act of settlement by an insolvent broker defined with relation to the provisions of the Bankrupt Statute might be lawful or unlawful dependent upon the State where it happened.

Under the So-called "Massachusetts" Rule, the Result Would Be the Same.

The argument for a preference, under the language of the Massachusetts cases, may be somewhat plausible, but is still quite incapable of standing the test of analysis.

As has been seen, it is necessary, in order to constitute a preference, that the bankrupt shall transfer *"his* property" (Bankrupt Act, Sec. 60 a); and it is urged that, under the "Massachusetts" rule, this is just what he does, since he is held to be the owner, under a contract to deliver to the customer; but do the Massachusetts cases, in truth, deny that, as between themselves, the securities purchased upon the customer's order belong not to him,

but to the broker; that the latter has the beneficial interest in them; and that when the customer receives them, he does so, not as owner, but as vendee? It is believed that they do not announce for any such proposition.

The first case cited is Wood vs. Hayes (15 Gray 375). There the broker advanced all the money to pay for the stock, and the customer never tendered the amount due. At all times before his death the broker, and thereafter his estate, was in a position to deliver the stock upon payment of the amount due (p. 375). The plaintiff's case rested entirely upon the erroneous proposition that the broker had no right to pledge the shares, and was consequently liable for their value at the time he did so (p. 376). Under these circumstances, the Court said:

> "The doctrine of trover does not apply. * * * It stands on the footing of contract. The contract was strictly conditional, to deliver so many shares on payment of so much money. The money was never paid and the title to have performance never accrued" (pp. 377-8).

At most this case upholds the broker's technical legal title prior to tender of the sum due. It does not touch upon the customer's equitable rights, or his status after tendering the amount due.

Covell vs. Loud (135 Mass. 41) merely asserts the right of the brokers, after the customer has refused necessary margin, and requested them "to do the best they could for him," to sell the stock at the brokers' board without notice. It is expressly stated (p. 44) that the result would be the same upon either the "pledge" or "contract" theory. Again, the Court did not deny the beneficial interest of the customer, but held merely that he had not such a title as would permit him to complain of the sale,—a sale, by the way, which would probably have been perfectly legal under the "New York" rule, under the circumstances disclosed.

Weston vs. Jordan (168 Mass. 401) does not touch upon the question. There the broker, Wheatland, had sold the customer's stock; and it was said:

> "After Wheatland had parted with the control of the shares, and after repeated demands for them by Jordan (the customer), and refusals by Wheatland to deliver them, Jordan had a valid ground of action against Wheatland, either for breach of contract or for a conversion; *it matters not which*" (p. 405).

The Court expressly declined to consider how far Massachusetts is committed to a different theory than that obtaining to New York (p. 404).

Chase vs. Boston (180 Mass. 458) holds merely that the certificates, standing in the name of the broker, are taxable to him. It has nothing to do with the respective rights of the customer and broker as between themselves. Finally, Rice vs. Winslow (180 Mass. 500) throws much light on the "Massachusetts" rule, and makes it plain that it is not at all what is here contended for it. There the customer was suing the broker for a sum of money, and the value of a bond, which he had delivered to the broker as margin, under a statute (Laws of 1890, c. 437, sec. 2) providing that:

> "Whoever upon credit or upon margin contracts to buy or sell, or employs another to buy or sell, for his account, any securities or commodities, intending at the time that there shall be no actual purchase or sale, may sue for and recover in an action of contract from the other party or from the person so employed, any payment made, or the value of anything delivered, on account thereof, if such other party to the contract or person so employed had reasonable cause to believe that said intention existed," etc.

Although the broker had purchased the securities ordered by the customer, the latter nevertheless contended that the broker, in delivering them to him, would be making a "sale" within the meaning of the statute; and as, in fact,

this was not contemplated, but instead that the broker should hold the stock for the customer and dispose of it as the customer should direct, the statute had been violated. The lower Court left it to the jury to say whether the relations of the parties were those of buyer and seller; and the latter found for the plaintiff. This judgment was reversed. Two propositions appear in the language of the opinion,—(*a*) that the purchase and sale referred to in the statute was that whereby the broker obtained the stock from the third person; but also (*b*) that the delivery by the broker to the customer was not a sale at all. The latter theory is fully as prominent as the former. The Court said:

> "Where a broker is employed to buy and carry stock on a margin, his relation to the customer in buying the stock is that of an agent. For the purchase of the stock the broker receives the same commission, and in the purchase of the stock he owes the same duty, that he owes to him, where he is employed to buy stocks, which are to be taken and paid for by the customer in place of being taken and paid for by the broker for the customer. * * * The authority of a broker to treat as his own the shares of stocks, which he has bought for a customer to be carried on a margin, is like that of a factor to mingle the proceeds of sales of the goods of several principals and to substitute his credit for those proceeds. * * * *In both cases the authority is derived from the necessities of the business of the agent.* In case of the broker carrying stocks on a margin, he has to raise the money to pay for them and is at liberty in doing so to pledge the securities which are to be carried, and, so long as he is solvent, to pledge them *en bloc* with other securities for the payment of money borrowed by himself in his own name" (pp. 502-3).

Here, at last, we have an instance of a practical application of the "ownership" and "sale" theory; and it is at once and emphatically repudiated by the higher Court.

These are the only cases of importance in determining

the "Massachusetts" theory as to the relations existing between stockbroker and customer. They certainly do not deny the customer's equitable right to the property. On the contrary, it is distinctly held that the broker buys as the agent of the customer; and it logically follows that when he delivers, it is as an agent to his principal. At most the Massachusetts Courts award to the broker a technical, legal title for his own security. An analogy to this may be found in the cases holding that a commercial correspondent, who has advanced his own money in buying property for his principal, and taken bills of lading in his own name, will be deemed to have title to the goods.

F. & M. Bank vs. Logan, 74 N. Y. 568.
Moors vs. Kidder, 106 N. Y. 32.
Drexel vs. Pease, 133 N. Y. 129.

This title, however, is given him solely to secure him for his advances, and confers upon him none of the general attributes of ownership. Drexel vs. Pease, *supra*.

So of the "sale" theory in Massachusetts. Chief Justice Holmes gave explicit warning that it was not to be taken too seriously when, in speaking of the respective "New York" and "Massachusetts" rules, he said: "No doubt, whichever view be taken, there will be anomalies, and no doubt it is possible to read into either a sufficient number of implied undertakings to make it consistent with itself." Chase vs. Boston, 180 Mass. 458, 459-60.

Conceding that the rights of the defendants with reference to the securities embraced in the account were, prior to June 26, 1903, based upon contract, they still had an equity which will be protected; and this Court has made a number of decisions which are controlling in principal, even if the facts considered were not identical. In Thompson vs. Fairbanks (196 U. S. 516) a chattel mortgage, covering after-acquired property, was made at a time when the mortgager was solvent. Such a mortgage being valid in Vermont, where made, it was held that the mortgagee

might take possession of such after-acquired property, and apply it upon his debt, although he did so at a time when the mortgagor was insolvent, and within four months of the filing of the petition in bankruptcy.

It was said:

> "Although there was no actual existing lien upon this after-acquired property until the taking of possession, yet there was a *positive agreement*, as contained in the mortgage and existing of record, under which the inchoate lien might be asserted and enforced, and when enforced by the taking of possession, that possession, under the facts of this case, related back to the time of the execution of the mortgage" (p. 524).

In that case, as here, the defendant took possession of the property without any fraudulent intent, but with knowledge of the condition of the bankrupt's affairs, and designing to forestall legal complications (pp. 520, 523). The inchoate rights of the Respondents here in June, 1903, were certainly as great as those of the defendant Fairbanks when he took possession of the after-acquired property. Possession here was taken under the agreement made on February 10, 1903, when the account was opened —at which time there is no evidence that Brown was insolvent, and which was more than four months prior to the filing of the petition. This agreement, of course, covered all securities which should at any time figure in the account, just as the mortgage in the Fairbanks case covered after-acquired property. The analogy seems perfect.

Johnson vs. Brooks (93 N. Y. 337) is, perhaps, even more closely in point. There the defendants took $3,000 of the plaintiff's money under the agreement to use it, together with other funds, in the purchase of certain stock and bonds, and, when the same was complete, to deliver a certain part thereof to him. Sufficient securities remaining in the hands of one of the defendants to satisfy this agreement, it was held that equity would require a

conveyance to the plaintiff of his share of the property. It was said:

> "The appellant cannot get over the fact that he obtained the shares and bonds under circumstances which prevent him from setting up ownership as against the plaintiff, and impose upon him at least a *quasi* fiduciary relation which he cannot avoid without the consent of *the real owner*. For the same reason it is impossible to find any merit in the appellant's objection to the interference of the Court because the property has risen in value. It was purchased with the plaintiff's money and with its increase belongs to him, and whatever its value may be, he is entitled to the subject of his agreement" (p. 344).

In the present case the petitioners have not even the temerity to deny that any increase in the value of the securities enured to the benefit of the Respondents. It will probably be urged that in the Johnson case the whole of the money was put up by the plaintiff. That is quite immaterial. When Brown, at the Respondents' request, consented to advance money to them, exacting their personal liability as well as the security of the property purchased, he certainly lost all right to claim that the purchases were made with his own funds. And in any case, when the Respondents, on June 26, 1903, paid him all they owed him, with interest, and he accepted it, he stamped the purchases previously made as made with the Respondents' funds, for their account. The much magnified difficulty, due to the failure to pigeon-hole special bonds and certificates for the Respondents, was present in the Johnson case, and was brushed aside without notice.

Other cases in which one having equitable rights in property has been permitted to perfect them during the insolvency, and to hold the property against the trustee in bankruptcy, are,

> Humphrey vs. Tatman, 198 U. S. 91.
> Yeatman vs. Savings Institution, 95 U. S. 764.

Hauselt vs. Harrison, 105 U. S. 401.
Sabin vs. Camp, 98 Fed. Rep. 974.

Though not identical in their facts with the present case, they are, each and every one of them, controlling in principle. The cases cited for the plaintiff (Weston vs. Jordan, 168 Mass. 401, *in re* Swift, 111 Fed. Rep. 503, 112 Fed. Rep. 315) are not in point. In the Weston case the broker had converted the securities by a sale and refusal to return them; and in the Swift case he was hopelessly insolvent and unable to perform his contract, and a tender and demand were, under the circumstances, held to be a useless ceremony. In the Swift case it is pointed out that the mere making of an assignment for the benefit of creditors does not show such an inability to perform as constitutes a breach of the agreement; and here, as we have seen, Brown was perfectly able to, and did, perform his contract. It thus seems clear that the "contract" theory existing in Massachusetts, however construed, is quite consistent with the existence of equities on the part of the Respondents which take precedence over the rights of the Petitioners as trustee. But if this were otherwise, there is another reason why the delivery of the securities to the Respondents did not constitute a preference which is just as applicable under the "Massachusetts" rule as any other, viz., that the effect of the transfer was not to enable the Respondents "to obtain a greater percentage of his (their) debt than any other of such creditors of the same class" (Bankrupt Act, Sec. 60 a). It is difficult, as already stated, to see how Brown ever owed the Respondents a "debt," since he punctually fulfil'ed all of his obligations on time, and in Swarts vs. Sigel (114 Fed. Rep. 1001) it was held that an accommodation indorser upon a note does not have a probable claim until he has actually made a payment upon it.

Upon the theory of a contract to deliver the securities, the argument for the Petitioner becomes somewhat more

plausible. Such a liability, however, would not be a "debt" referred to in Sec. 60 a, which of course means (Sec. 1 [11]) a "debt, demand, or claim provable in bankruptcy." The liability was purely conditional upon a proper tender from the Respondents; and this they might never choose to make—quite certainly would not choose to make if the value of the securities fell below the purchase price. The present Bankrupt Act makes no provision for proving contingent liabilities; but, assuming that this may be done, as under previous statutes (see Collier on Bankruptcy, 5th Ed. p. 489), such an obligation is not provable where it is wholly uncertain whether the contract or engagement will ever give rise to an actual duty or liability.

Riggin vs. Maguire, 15 Wall. 549.

But, passing this, the transfer did not have the effect specified. The underlying idea is that the bankrupt shall not deplete his estate to the prejudice of other creditors. (N. Y. Co. Nat. Bank vs. Massey, 192 U. S. 138, 146.) A transfer of his property, of itself, may be perfectly innocent. As this Court has said:

> "A fair exchange of shares may be made at any time even if one of the parties to the transaction be insolvent. There is nothing in the Bankruptcy Act, either in its language or object, which prevents an insolvent from dealing with his property, selling or exchanging it for other property at any time before proceedings in bankruptcy are taken by or against him, provided such dealings be conducted without any purpose to defraud or delay his creditors or give preference to any one, and does not impair the value of his estate. An insolvent is not bound, in the misfortune of his insolvency, to abandon all dealing with his property; his creditors can only complain if he waste his estate or give preference in its disposition to one over another. His dealing will stand if it leave his estate in as good plight and condition as previously." (Cook vs. Tullis, 18 Wall. 332, 340.)

To the same effect, see,

Clark vs. Iselin, 21 Wall. 360, 373.
Sawyer vs. Turpin, 91 U. S. 114, 120-1.
Stewart vs. Platt, 101 U. S. 731, 743.

There is no claim that the price paid by the Respondents for the securities was not a fair one; and there can consequently be no question that, if the entire sum had been paid on June 26, 1903, Brown's creditors would have had no right to complain. The alleged injustice is simply this—that, whereas the Respondents had previously paid part of this purchase price and received credit therefor, and were thus able, under their contract with Brown, to obtain possession of the property on June 26 by paying less than its value, their doing so, though perfectly equitable as to Brown, constituted a fraud upon his creditors. In other words, the defendants, during the period from February 10 to June 26, 1903, though they thought, and Brown thought, that they were making payments on account of their goods, were in truth creating a fund to be distributed among his creditors. Of course the Petitioner has no right to confine the transaction to what took place on June 26. The whole of it must be considered; and the defendants' equities, as thereby established, respected.

Thompson vs. Fairbanks, 196 U. S. 516, 524, 526.
Humphrey vs. Tatman, 198 U. S. 91.
Yeatman vs. Savings Institution, 95 U. S. 764, 766.
Hauselt vs. Harrison, 105 U. S. 401.
Sabin vs. Camp, 98 Fed. Rep. 974.

It is argued that Brown converted the Respondents' securities when he repledged them in his own loans just as much as though he had sold them. Of course that is not true, since this was agreed to. No dealing with my property to which I consent can be a conversion. But it is urged that Brown, in order to get back the property, was

forced to part with money and property of his own; and, as we understand the argument, that *this* constituted a preference. Plainly, however, it did not. As between Brown and Brown, Riley & Co. there was no preference, for the latter had a lien upon the securities which, beyond question, would have taken precedence of the general creditors; and no more was paid than was necessary to extinguish this lien. As the testimony shows, this transaction between Brown and Brown, Riley & Co. had nothing to do with the Respondents (fol. 119). Primarily, at least, Brown's object in paying the money was to get back property in which he had an interest. Of itself, it did not prefer the defendants, or have any tendency so to do; and, even if its indirect result was to prefer them, there would still be no violation of statute. N. Y. Co. Nat Bank vs. Massey, 192 U. S. 138. In this case it was held that a bank might set off against a debt of the bankrupt his account with it, though created by deposits made during the four month period, since the payments were made, not in order to prefer the bank, but to obtain credit with it.

Still more closely in point is Swarts vs. Sigel (114 Fed. Rep. 107), holding that the payment by the bankrupt, within the four months, of a promissory note is not a preference of an accommodation indorser upon it, although the latter might otherwise have been forced to pay it and take his chances with the other creditors.

Both the Massey and Sigel cases are much stronger in their facts for the plaintiff than the case at bar. In the former nothing was necessary to the preference, after the making of the deposit, but the election of the creditors; and in the latter the very act of payment had the effect of discharging the indorser's contingent liability. Here, however, a separate and independent act of the broker was necessary before a claim of preference became even plausible; and the only reasonable course is to scrutinize this latter act, not what preceded.

The Parties Were Engaged in a Joint Venture.

Learned counsel for Petitioner is not content with expressing ~~their~~ his dissatisfaction of the New York rule. He also disapproves the Massachusetts rule. But he must have some rule, and he placidly calls the transaction a joint venture. Humor and levity do not find proper place in a brief presented to this Court, but the humorous suggestion of counsel warrants this comment. The broker obtains his sole profit, and he never loses, from his commissions paid from the margins of the customer. The picture is presented of the festive broker leading the bulls and bears to the door of the stock exchange and confidentially whispering this is our "joint venture"; you may win; I never lose.

The sufficient objection to this is that it flatly contradicts the facts. The broker is *not* interested in the venture, for he does not gain if it wins, or lose if it fails. Nor is anything properly to be termed an "accounting" necessary in order to do justice between them. An agent has bought so much property for his principal, and advanced so much money upon it. The case does not differ in any important respect from the ordinary one of factor and principal.

Further, in assailing the "pledge" theory, the argument, instead of being advanced, is extremely archaic, consisting of the contention that there cannot be a pledge of a *chose in action*. This argument might have found favor a hundred years ago, but is now thoroughly exploded.

> "The settled law now is * * * that incorporeal personal property, such as negotiable instruments, bonds, and choses in action generally, is capable of being pledged by written transfer of the title. * * * It is well settled by the authorities that shares of stock in an incorporated company, however unsubstantial may be their character, or however, fluctuating their value, may form the subject of a

pledge equally with a cargo of wheat, a vessel, or any other specific article" (22 Amer. and Eng. Enc. of Law, 2nd ed., pp. 846-7 and cases cited).

The Withdrawal by the Defendants of $5,000 on June 24, 1903, was not a Preference.

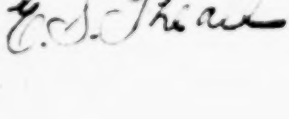
What has been said fully covers this point. Even if Brown, in making this payment, was paying a "debt," and thereby made a preference, that preference was extinguished two days later when the Respondents paid him the full amount of his advances. They were obliged when the account was settled, to pay exactly $5,000 more than they otherwise would, for their margin was decreased to just that amount. It is absurd to contend that this money never came back to Brown because the check was made out to Brown, Riley & Co. That was merely a matter of book-keeping. The case is precisely the same as though the check for $34,919.62 had been made out to Brown, and by him indorsed to Brown, Riley & Co. This use of the check (which included the $5,000) canceled, *pro tanto*, his debt to Brown, Riley & Co.; and money so applied, with his consent, was certainly paid to him.

In truth, however, Brown, in paying this money, was not paying a debt. He held securities which were eventually to be turned over to the Respondents, and upon which they had made payments on account; and, since the equity in the property considerably exceeded the amount of his lien, he was willing to make further advances. The $5,000 payment was such an advance; and, when the goods came to be paid for, was included in the other indebtedness of the defendants.

The transaction should be considered as whole. It is merely confusing to scrutinize a single section of it. So considered, Brown bought property for the defendants, which they agreed to take from him at a fair figure—to

wit, the amount he had paid, plus a commission and interest on his advances. This agreement was fully executed; and it in no way depleted the bankrupt's estate, whatever construction is placed upon it. The payment of the $5,000 on June 24, as well as the various acts of the parties before and after, were but incidents of this general transaction, which did not disturb its purpose or result.

We respectfully submit the judgment of the Circuit Court of Appeals should be affirmed with costs.



FRANCIS FITCH,
JOHN A. L. CAMPBELL,
Of Counsel for Respondents.

Office Supreme Court, U. S.
FILED.
JAN 20 1908
JAMES H. McKENNEY,
CLERK.

Supreme Court

OF THE UNITED STATES.

HENRY ARNOLD RICHARDSON, as Trustee in Bankruptcy of J. Francis Brown,
Petitioner,

against

JOHN M. SHAW, and another,
Respondents.

No. 122.

Petitioner's Reply.

It is desired to submit a short reply in order to differentiate this case and *Thomas* v. *Taggart*, No. 197, and thereby to lay emphasis on our main proposition.

There, if we understand the facts aright, the customer took from her strong box two certificates of stock and pledged them to her broker as security against loss by him on a speculative account which he was carrying on for her; and there was nothing in their agreement which gave him the right to repledge those particular certificates; they seem not to have been pledged to help him carry her stocks, but to secure him against loss in so doing; the contingency did not happen; a profit was made instead of a loss, and at the time of the broker's failure there was a balance due to her. His trustees in bankruptcy came into possession of the identical certificates without having parted with value. She demanded them, her claim being "You have my property; it was pledged to the bankrupt as security for a contingency which never happened; it was the bankrupt's duty to return it to me; please hand it over." They say they cannot do so, for she is a creditor and it would be a preference.

If their answer is sound, *a fortiori* the transaction in our case was a preference and no further argument from us is

needed. If it is not sound, the converse by no means follows. The element on which we base our claim here is wanting there. *No agreement was made between that broker and that customer, which resulted in connecting her certificates with those of any other customer in any general loan.* The only feature in common between that case and this is that our respondents had pledged to the broker the two Shannon bonds mentioned in point 3 of our brief (p. 28). But even as to them there is a difference. In the Taggart case the customer did not consent that the certificates in question might be repledged. It was part of our respondents' agreement that their broker might pledge the Shannon bonds as well as the other securities.

We are all the more anxious to put stress upon this, for that the learned court below entirely ignored our main proposition, as does also the learned counsel who has just filed a supplemental brief. Our other opponents seem to have misconceived it. In their statement (pp. 5-6), as to what "petitioner contends," they set up a man of straw and then proceed to knock him over. Again, at the end of page 30, they actually appear to think that we had advanced the archaic contention that there cannot be a pledge of a chose in action. What we had asserted was that conversion can only be predicated of a certificate of stock in possession, and not of a chose in action which it represents. They make merry over what they are pleased to call a "humorous suggestion of counsel" (p. 30). It may be that when customer and broker join their funds in the ratio of 1% by the customer and 9% by the broker for the purchase of stocks on speculative accounts, and make certain agreements as to how the speculation shall be carried on, it may be that the New York cases are right in saying that although the legal title to the certificates is apparently in the broker it is nevertheless in the customer. On the other hand it may be that the Massachusetts cases are right in holding that such title is in the broker under the tax law and in the customer under the gaming law. It may also be that our suggestion should be tossed aside as a bit of humor, and the theory that the *equitable title* to certificates of stock in a speculative account is *in both customer and broker* is not worthy of serious consideration. So be it. Our case does not hang on the New York theory or the Massachusetts theory, the contango theory or the joint adventure theory. We simply advanced the latter so that, if there is to be a battle

royal between contending theories, one which is based on facts and not fiction, one which brings within its content a fact which the others leave out, viz.: the pledge by the broker of variously owned certificates on one loan, shall not be overlooked. We use the phrase "variously owned certificates" in deference to the New York theory. We earnestly submit that it is not necessary in this case to pass on the relative merits of those theories. No doubt it would be desirable for the great court of the nation to set the seal of its approbation on the correct theory, but it is not indispensable here, for it is an academic question by reason of the customer's consent to the pledge on general loans.

As to that proposition none of our opponents make merry or make answer. Not a case which they cite contains a deliverance upon it. The relations of customers to their common broker *and to each other* under the tangled conditions, which result, when he jointly pledges under their several agreements with him their several stocks upon general loans to himself, have not been the subject of any discussion by any court in any case.

It seems to be thought by our opponents that it is the transfer of the securities aggregating in value $45,583.75, which we are attacking as a transfer of the property of the bankrupt to the defendant. Nothing of the sort. Our contention is as follows. When a stock broker so carries on his business under agreement with his several customers that on loans to himself he may pledge jointly the stock severally carried for each, *he comes under an obligation to each* to redeem the stocks so carried for each from the general loan. This obligation on his part creates a correlative right of demand on their part, which puts him into the debtor class and them into the creditor class, according to the plain definition of the bankruptcy law (§1); so that if he being insolvent uses any assets of his own to carry out such an obligation to a particular customer, whereby the latter may be able to redeem his stocks from such general loan upon payment only of the amount of his indebtedness to the broker, with the result that the broker cannot carry out similar obligations to his other customers in like case, then it is a preference under Section 60. We submit that this is so under any theory as to the relation between broker and customer. This is the main proposition on which we hang this appeal. It is well that

it should for the first time be treated in a bankruptcy court, which has in mind all the parties in interest even though they be not actually represented on the record.

II.

This reply ought not to be closed without calling attention to three passages in the brief of the able counsel, who has just come into the case, which passages, as we humbly conceive, clinch the case against his clients.

We shall make no reply to his brief as a whole. Upon the assumption, the correctness of which we are strenuous to deny, that if the New York theory be adopted by your Honorable Court it requires an affirmance of the judgment, he spends his force in pressing the argument *ab inconvenienti*. In view of the singular coincidence, which we understand has never before happened in the history of the Court, that there sit upon your Honor's bench an exponent of the New York theory and an exponent of that of Massachusetts, each coming from the court of last resort in his State, we have not felt that we could contribute anything of value to a debate upon the relative merits of those two theories. We have, therefore, contented ourselves with pointing out that each involves conceded inconsistencies and anomalies. The three passages in his brief to which we refer emphasize our contention that under the now universal custom of the broker pledging the certificates which he carries for all his customers upon general loans, to which all his customers are required to consent, the Courts in passing upon the relations thereby created should do so not from the narrow standpoint of one customer, but should bring within view of its equitable eye all the customers in like case.

(1) On page 2 it is said that "respondents demanded their stocks from Brown, paying him the balance of their indebtedness on account of the purchase of the shares, and the stocks were delivered in compliance with this demand."

The record shows that the respondents did not pay to Brown their indebtedness, but paid it to Brown's pledgees by a cheque to the order of the latter (Rec., p. 39, Exhibit 7). The securities were delivered to respondents' agent by the

pledgees' agent (the bankrupt's clerk being entrusted with them for the purpose of such delivery). The bankrupt had enabled this to be done by turning over to the pledgees $1,200 in cheque and a note for $5,000, thereby increasing his margin of credit, and upon the consummation of the transaction with respondents that margin, to use the expressive language of the witness Fletcher, *"was wiped out"* (Rec., p. 22, fol. 40, line 11)—that is, to the extent of $10,664.13. In other words, the insolvent being under an obligation to respondents to redeem their stocks from his general loan, so that they might get them on paying the amount of their indebtedness, $34,-919.62, makes an equitable transfer to them of an interest in his margin of credit with his pledgee to the extent of $10,-664.13, and with that credit thus equitably assigned to them and with the $5,000 which the insolvent has just paid them and with $29,919.62 of their own money they go to the pledgee and get their stocks. *That* is the transfer of property to these defendants which we are attacking as a preference. If it was not a transfer by an insolvent of his own property to a person who had a demand against him, what was it?

(2) On page 31 it is said: "In making delivery of the shares to the respondents, Brown was merely doing what a court of equity might have required him to do under the circumstances."

Exactly so, and only by a court of equity could he have been so compelled. He could not have been sued in conversion on pledging the stocks to Brown, Reilly & Co., because it was done with respondents' knowledge and consent. (*Ogden* v. *Lathrop*, 65 N. Y., 158.)

Suppose respondents had gone into equity to compel Brown to give them their stocks on a tender of their debt for the balance of their purchases and Brown had answered, "I have not your stocks in my possession, with your consent I pledged them to Brown, Reilly & Co. on a general loan to myself." What then? Could a court of equity do anything without bringing in Brown, Reilly & Co. as parties? Suppose on their being brought in they had said, "The securities in question were pledged to us along with a lot more, in which other customers of Brown are interested, Brown is insolvent and if we use up his margin in giving the plaintiffs their stocks, it will result in injury to his other customers in like case."

What then? Could a court of equity do anything without bringing in the other customers and marshalling the securities? Would it proceed on any other principle than that equality is equity? Is not that what the bankruptcy court is to do? Is not that what the bankruptcy law compels the insolvent to do during four months before bankruptcy?

(3) After saying (p. 36) that when respondents withdrew the $5,000 "they simply exercised one of their rights under the agreement"—and language could not have been more apt to describe Brown's obligation to pay it and therefore his status as a debtor—it is said, "If a watch worth $100 were pawned for a debt of $25 and afterwards the pledgor, knowing the pledgee to be insolvent, should obtain a further advance of $25 upon the same security, no one would assert that that was a preference."

Again, exactly so. But if the pledgor, knowing that the watch had been repledged with his consent for $50 and that by reason of his pledgee's insolvency he could not get his watch without paying the second pledgee $50, should then go to his own pledgee and demand $25 more in order that he might use it to redeem his watch from the second pledgee, could it be for a moment contended that this was not a transfer of $25 to him in violation of section 60?

This very illustration of counsel, which is borrowed from us (see our brief, p. 11), but only borrowed in part, clears up the whole situation. The respondents knew of Brown's insolvency. They knew that he had pledged their securities on general loans. They knew that on his anticipated failure they stood to lose some $15,000. They demand on one day and get $5,000.

> All the counsel agree that the payment of the $5,000 June 24th and the closing of the account June 26th should be regarded as one transaction.

Next day they demand their securities. The insolvent gives his own pledgee $1,200 in cash and a note for $5,000, and thereby strengthens his margin of credit. Then the respondents with the $5,000, which he had just paid them, and with $29,919.62 of their own money, and with an equitable assignment to them of Brown's margin of credit with his

pledgees to the extent of $10,664.13 go to the latter and redeem their securities. Now, if the transfer by this insolvent to these respondents of values (*Weston* v. *Jordan,* 168 Mass., 401) to the extent of $15,664.13 was not a transfer of his property, what was it? He did not keep it. His pledgees did not keep it. It did not go to his other customers. Respondents got the benefit of it. They got it because of his obligation to give it to them. The effect of it was to enable them to get a greater percentage of that obligation than any other of the insolvent's customers who had similar demands, as is shown by the specific admission on page 8 of the record.

> *"That among the creditors of said Brown there was on said day a number of general creditors upon transactions for purchase and sale of stocks by said Brown as broker similar to the transactions for purchase and sale of stocks by said Brown as broker for the defendants."*

Hence this action was well brought by the trustee in bankruptcy.

JOHN BROOKS LEAVITT,
Of Counsel.

George F. Ebert, Law Printer, 22 Ann Street, New York.

Office Supreme Court, U. S.
FILED.
NOV 16 1906
JAMES H. McKENNEY,
CLERK.

Supreme Court of the United States.

HENRY ARNOLD RICHARDSON, as Trustee in Bankruptcy of J. Francis Brown,

vs.

JOHN M. SHAW and ALEXANDER DAVIDSON.

No. 122.

Please take notice that a motion to advance this cause will be made to the Supreme Court at its court room in the Capitol at Washington on Monday the 19th day of November, 1906, at the opening of the court or as soon thereafter as counsel can be heard, and that it be set down for a particular day on account of the following special and peculiar circumstances:

(1) That the question involved affects many persons, stock brokers and their customers all over the country,—such question being whether customers of an insolvent stock broker, who is carrying for their respective accounts on margin stocks, which with their consent he has pledged on general loans, are creditors within the meaning of the preferential section of the Bankrupt Law; and if not so generally

then at least in Massachusetts, whose stock law differs from that of New York.

(2) As two Circuit Courts of Appeal are in direct conflict, the first circuit holding that customers are creditors when proving claims, and the second circuit holding that they are not creditors when obtaining preferences, much confusion in administering the Bankrupt law must necessarily ensue, if the decision of the question is long postponed.

(3) As two States are in direct conflict as to the relation between stock broker and customer in respect of speculative accounts; New York, where this case was tried, holding that they are parties to an executed contract whereby the customer becomes owner of the stocks and pledges them to his broker for the balance due on the purchase price; and Massachusetts, where the transactionsoccurred, holding that they are parties to an executory contract, whereby the broker is under obligation to deliver stocks certain at a price certain on demand, and the customer does not own them until payment and delivery; the confusion due to the said contrariety of opinion between the two Circuits will be much increased.

(4) As the decision below, in adopting the New York view rather than that of Massachusetts completely nullifies the Bankrupt Law, so far as preferential transactions of stock brokers are concerned, an early decision of the question is desirable not only for the purpose of settling existing controversies, but avoiding future ones, which must surely arise in view of the vast numbers of customers who

buy stocks on margin, and the universal habit of brokers to carry such stocks by means of general loans.

Dated October 26th, 1906.

Yours, &c.,

JOHN BROOKS LEAVITT,
Attorney for the Plaintiff in Error.

To
Messrs. Campbell & LaFar,
Attorneys for the Def'ts. in Error.

George F. Ebert, Law Printer, 22 Ann Street, New York.

Office Supreme Court U. S.
FILED
OCT 3 1906
JAMES H. MCKENNEY,

Supreme Court of the United States.

HENRY ARNOLD RICHARDSON, as Trustee in Bankruptcy of J. Francis Brown,
Petitioner,

vs.

JOHN M. SHAW and Alexander Davidson,
Respondents.

No. [redacted]122.

Petitioner's Brief.

Petition for a writ of certiorari to bring here the record in a suit begun by petitioner against respondents in the District Court for the Southern District of New York, and carried by writ of error to the Circuit Court of Appeals for the Second Circuit.

The action was brought by the petitioner as a Trustee in Bankruptcy to recover a preference.

Questions Involved.

The exact point up for decision was, whether customers of an insolvent stock broker, who is carrying for their respective accounts on margin stocks, which with their consent he has pledged on

general loans, are creditors within the meaning of the preferential section of the Bankrupt Law; and if not so generally then at least in Massachusetts, whose stock law differs from that of New York.

Seldom comes into Court a more important, never a more interesting, question.

Important, for that

(1). It affects many persons, brokers by the tens, customers by the hundreds of thousands.

(2). Two Circuits Courts of Appeal are in direct conflict, the first circuit holding that customers are creditors when proving claims, and the second circuit holding that they are not creditors when obtaining preferences.

(3). Two states are in direct conflict as to the relation between stock broker and customer in respect of speculative accounts; New York, where this case was tried, holding that they are parties to an executed contract, whereby the customer becomes owner of the stocks and pledges them to his broker for the balance due on the purchase price; and Massachusetts, where the transactions occurred, holding that they are parties to an executory contract, whereby the broker is under obligation to deliver stocks certain at a price certain on demand, and the customer does not own them until payment and delivery.

(4). The decision below, in adopting the New York view rather than that of Massachusetts completely nullifies the Bankrupt Law, so far as preferential transactions of stock brokers are concerned. It puts them in a favored class, so that they may prefer one customer and be discharged from their obligations to the rest.

(5). The salient fact, which now through special

agreement usually enters into such transactions, whether in New York or Massachusetts, to wit, the customer's consent to the broker's pledge of the stocks on general loans, has a direct bearing in this controversy, has never been up before for consideration, and was ignored below.

Interesting,

(1). As a nice point in law, arising on an undisputed state of facts.

(2). By reason of a coincidence.

In this august tribunal sits a justice, who as a member of the Court of Appeals of New York took part in decisions, which recognized the New York theory as first laid down in Markham v. Jaudon. Also there is a justice, who as a member of the Supreme Court of Massachusetts wrote the opinion in the case, which upheld the contrary doctrine as first laid down in Wood v. Hayes. It concludes with these words. "We see no reason for departing from what has been understood to be the law of Massachusetts ever since the time of Chief Justice Shaw."

There is, indeed, a preliminary question, whether the petitioner may not come here by writ of error.

The case is not one in which the jurisdiction is dependent upon different citizenship, nor is it a case arising under the patent laws, or revenue laws, or criminal laws, nor is it in admiralty (Act of March 3rd, 1891, Section 6).

It is a controversy arising under the Bankrupt Law. We do not find any decision in this Court construing subdivision d of Section 25 of the Bankrupt Act as to its effect upon such a case as this.

We submit this preliminary question without argument, for we make bold to believe that even

if the petitioner is entitled to a writ of error, the desirability of an early settlement of conflicting constructions of the Bankrupt Law is such as to warrant this application.

The Facts.

Brown, a stock broker in Boston; respondents a firm in New York, customers of Brown on speculative account for purchase and sale of stocks on margin managed by their Boston agent; all transactions begun, continued and ended in Massachusetts; carried on for several months, February to June 1903; respondent's margin started with $500, amount to their credit increased by gains and deposits to about $16,000; Brown pledged to various bankers the securities, deposited with him and bought by him on their account *on general loans;* this *pursuant to agreement;* became insolvent in June; respondent's agent on learning of the insolvency demanded cash payment of $5,000, received it June 24; then demanded the securities; obtained them in the following way; securities assembled in hands of Brown, Riley & Co.; insolvent's "margin on loans" with latter about $10,000; accounting between insolvent and respondents showed value of stocks to be delivered to them $45,583.75, amount to be paid by them $34,919.62, (increased by the $5,000, paid to them the day before); insolvent turned over to Brown, Riley & Co., his check for $1,200, and a note of a debtor for $5,000, which with the $10,000, "margin" to his credit with Brown, Riley & Co., made them willing to part with possession of the securities in question; thereupon, defendants' banker gave Brown, Riley & Co. a check for the $34,919.62, and received from them

the securities; insolvent made assignment next day was adjudicated bankrupt within four months, and petitioner was elected trustee.

> Record, folios 43-45, 151-168, 148-150, 40, 67, 70, 77, 99, 102, 116-118, 181, 43, 18.
>
> (Citations in the sequence of the statements.)

The respondents conceded at the trial "that among the creditors of said Brown there were on said day a number of general creditors upon transactions in purchase and sale of stocks by said Brown as broker similar to the transactions in purchase and sale of stocks by said Brown as broker for the defendant" (fol. 43.)

> As the Courts below held that customers are debtors not creditors, we do not construe the use of the word creditors in this admission as a concession on the law point. All that was meant was that there were other customers in the like case with respondents. They all constituted one class, each occupying similar relations upon similar transactions. In devoting $15,664.13 of his assets to help one of them, the insolvent injured the rest. The Court may rule that they are debtors, but they have a sad knowledge to the contrary.

The foregoing summary is believed to be sufficient for the purposes of the present application. Its accuracy will not be denied, bearing in mind that the knowledge of insolvency, (the only disputed fact in the record) is here assumed for the purpose of presenting the law point. The Petitioner requested to go to the jury on the issue of knowledge of insolvency (fol. 126).

The action was brought on the theory that under the law of Massachusetts (proved as a fact, fol. 56) the respondents were creditors of the insolvent, that the payment by the insolvent of

$5,000, to them was a transfer of the insolvent's property to them as creditors and therefore a preference; and that the transaction of the following day was an accounting between the parties, whereby under the law of Massachussetts the defendants were found to be indebted to the insolvent in the sum of $34,919.62, and he was found to be obligated to deliver to them securities at the price of $45,583.75, and that he transferred to them property of his own of the value amounting to the difference $10,664.13, and such transfer was also a preference. We contended that it is immaterial whether the property he so transferred be considered as consisting of his interest to that extent in the particular securities so transferred, or of that amount of his "margin" with his own pledges, which must be deemed to have been orally assigned by him to the defendants. It was the insolvent's parting with his interest in that "margin" that enabled the respondents to get the securities from his pledgees. The net result was that the insolvent transferred to respondents assets of his own to the value of $15,664.13.

The Courts below ignored the Massachussetts theory and applied that of New York, and held that the respondents were the owners of the property transferred to them, and the only relation they occupied to the insolvent was that of debtor for the balance of the purchase price, and hence that there was no transfer to a creditor of any property of the bankrupt in payment of any debt.

The result is that the other customers of the bankrupt, who are in exactly the same case, get nothing. Thus we have an anomaly. The customer, who is preferred, may keep what he gets, for he is a debtor; and the customer who is not preferred may prove his claim, for he is a creditor.

Reasons for a Certiorari.

The Trustee, charged by the laws of the United States with the duty of attacking preferential transactions, ventures to think that the situation thus disclosed is one which needs the attention of the Court.

For the following reasons:

1st. Two Circuit Courts of Appeal are in direct conflict. The First Circuit holds that a stock broker in Massachusetts, who by virtue of his insolvency is not able to deliver to a customer securities, which under the law of Massachussets he is obligated to deliver upon demand and tender of a certain price, is a debtor within the meaning of §57 of the Bankrupt Act.

> In re Swift 112 Fed. Rep. 319 affirming, the opinion of the District Judge in 105 Fed. Rep. 493.

The Second Circuit holds that an insolvent Massachusetts stock broker, in carrying out such an obligation with one of his customers at the expense of the others, is not a debtor to that customer within the meaning of §60 of the Act.

> See its opinion attached to the petition affirming the opinion of the District Judge at fol. 126 of the record.

In other words, whether a customer in Massachusetts is a debtor or a creditor of his broker, within the meaning of the Bankrupt Law, depends upon the favor of the broker. When the broker is only insolvent and favors a particular customer, that customer is his debtor; but if the broker should refuse to favor

him and become a bankrupt, that customer would be turned into a creditor.

Thus the customer's status depends on luck rather than law.

Is this a situation contemplated by the Bankrupt Act?

Does it not need the attention of this Court?

A conflict between two Circuit Courts of Appeals is ground for a writ of certiorari.

> Forsyth v. Hammond, 166 U. S., 506.
> Columbus Watch Co v. Robbins, 148 U. S., 266.

2nd. The learned Circuit Court of Appeals ignored our contention, that by the *lex loci* the insolvent was a debtor of the respondents, because he was under obligation to deliver to them on demand certain securities at a certain price, and also under further obligation to pay them money in case their "margin" was more than 10 per cent., and in compliance with those obligations he transferred to them $5,000 of his own money in cash and assets of the value of $10,664.13. In Massachusetts he was clearly a debtor and they were creditors within the meaning of the Bankrupt Law.

> Wood v. Hayes, 15 Gray., 375.
> Coville v. Loud, 135 Mass., 41.
> Weston v. Jordan, 168 Mass., 401.
> Chase v. Boston, 180 Mass., 458.
> *In re* Swift (*supra*).

The case of Weston v. Jordan is in all material aspects exactly the case at bar. That the learned District Judge erred in attempting to differentiate

it is obvious, when it is observed that the only difference of fact between them is, that after parting with the stocks (in our case by pledge) the broker in Weston's case with his own money bought other certificates for his customer, and in ours with his own money aided his customer to take up the stocks (by different certificates, fol 122). Is that a difference in principle?

The learned judge, who wrote the opinion on affirmance evidently appreciated the necessity of distinguishing the case at bar from Weston v. Jordan, for he says at the close, "Of course, a different situation would have existed if Brown had disposed of the stock and had refused for that reason to deliver it on the defendant's demand." This makes it all the more incomprehensible to us why our main contention was so completely ignored (*infra*).

In Chase v. Boston, the Court refuses to adopt the New York theory (per Holmes, C. J.).

> It matters not whether that $10,664.13 is in the difference between the value of the securities and the amount the respondents paid on the accounting, or is in the insolvent's "margin" of credit with his pledgees, Brown, Riley & Co., which credit he orally assigned to respondents so that they could get the securities in question from those pledgees on paying the said $34,919.62.
>
> The fact remains that on the day of the accounting, if defendants had not obtained the securities, they would have had, under the law of Massachusetts a provable claim for $10,664.13, which claim would not have been as in New York, *ex delicto*, but *ex contractu*. If the insolvent had been adjudicated a bankrupt before he made his payment of $5,000, then respondents would have been creditors under the law of Massachusetts, in the sum

of $15,664.13. They were not creditors, simply because the insolvent carried out his obligations to them by transfer to them of his own property.

The respondents not being residents of Massachusetts, the suit had to be in New York. The petitioner brought it in a national rather than a State Court, in order to get as far away from the atmosphere of Markham v. Jaudon, as possible. Having failed to get very far away from it, he now seeks to get above it.

3rd. The learned Circuit Court of Appeals also ignored the petitioner's contention that the customer's consent to the broker's pledge of the securities on general loans had the effect to render the difference between the New York and Massachusetts theories immaterial.

> Under the Massachusetts theory, the broker may rightfully pledge securities which he buys on customer's account. Under the New York theory, such a pledge is a conversion. But if the customer agrees to it, there can be no conversion. Even under the New York theory, that the pledge of a customer's stocks on general loan is a conversion, the customer becomes a creditor and has a provable claim in bankruptcy.
>
> Crawford v. Burke, 195 U. S., 176.
>
> Hence, where a broker has been guilty of a conversion thus turning his customer into a creditor with a provable claim, if he uses assets of his own to prefer that customer, such a transfer would be clearly a preference even under the New York theory.

But what we claim is this, that even if the New York theory of the relation is the correct one, yet if the broker pledges the securities on gen-

eral loans *with the consent of the customer*, the relation then becomes exactly the same as that under the Massachusetts theory, and the customer is turned into a creditor *ex necessitate*. Is it to be said that a broker, whether in New York or Massachussetts, who pledges the stock bought for customers upon his general loans, and does so with their consent, is under no obligation to protect those customers from the consequences of those loans? Is it to be said that if in recognition of the obligation to protect them, the insolvent broker favors one of his customers by devoting his own assets in order to enable that favored customer to get the stocks purchased on his account, that this is not a preferential transaction as against the other customers to whom he is under similar obligations, and who are in the same case with the favored one? Is there any reason why one customer should be favored by an insolvent stock broker at the expense of the others? Is there any reason why the Bankrupt Law should be so construed as to permit a stock broker thus to favor one of his customers at the expense of the others?

It is not our intention here to repeat the argument of our brief below. All we suppose to be necessary now, is to show to the Court that the case is of sufficient gravity to make it desirable to have the record brought here.

This transaction cannot, we submit, be regarded simply as a transaction between a broker and a single customer. This was a speculative account and there were a number of other customers in exactly the same situation. The moment that a broker pledges the stocks, which he is carrying for various customers, upon general loans to himself, each cus-

tomer comes into an indirect relation with every other customer. It matters not whether the broker does this as of right under the law of Massachusetts, or by special agreement. If they consent to his carrying on his business in that way (and in no other way can it be carried on) thereby eliminating from the transaction the element of conversion, the difference between the New York and Massachusetts theories becomes academic, for he must in both States be under an obligation to protect each customer from the consequences of such general loans. No one of them can come forward and say to the general pledgee, such and such are my securities and you must give them to me upon the payment of so much of my broker's loan as represents the amount I owe to him; because if one customer has that right, then every other customer has the same right; and the result would be that if the general pledgee responds to such demands, the moment will come when he will have no security for a balance due on his loan if it amounts to more than the sum of the amounts due by the customers. Hence, in case of the insolvency of the broker, the interposition of a Court of equity is necessary to marshal the securities and to adjust the several rights and obligations of broker, customers, and pledgees.

During the four months prior to bankruptcy, an insolvent must do what a court of equity would and marshal his assets on the principle that equality is equity. Now, unless the transaction at bar is held to be a preferential transaction under Section 60, then so far as stock brokers are concerned the Bankrupt Law is a failure. Indeed, it is worse than a failure, because under the con-

struction of the learned Courts below, insolvent stock brokers are put into a favored class, may prefer which customer they please, and yet be discharged in bankruptcy from obligations to all the others.

We submit that such a result ought not to receive the sanction of the Courts, and that the customers of insolvent stock brokers should be placed in the same category as all other persons having dealings with insolvents. Certainly it cannot be said that Congress in its wording of Section 60 ever intended such a travesty.

Stirred by the inequity, which was worked by the application of New York law to this case, and spurred by the numerous contradictions and inconsistencies, in which it has involved her courts, we had the temerity on the appeal below to present a theory of the true relation of broker and customer in respect of speculative accounts of stocks on margin. It was based on the actual customs of the business, and not as in Markham v. Jaudon upon assumptions at variance with those customs. We use the word "speculative" to differentiate such accounts from the ordinary case of buying stocks for investment. We may use it without fear, for that the Court of Appeals in New York has recently said, that the "purchase of stocks through a broker, though the party ordering such purchase does not intend to hold such stocks as an investment, but expects the brokers to carry them for him with the design on the part of the purchaser to sell again the stocks when their market value is enhanced is, however, speculative, entirely legal."

Hurd v. Taylor, 181 N. Y., per Cullen, C. J., at page 233.

It was the failure to note the difference between a speculative and an investment account, which as we humbly conceive vitiated the decision in Markham v. Jaudon (41 N. Y., 235). The decision of the N. Y. Supreme Court in Kennedy v. Budd, 5 App. Div., 140, is a forcible illustration of the error in the main assumption on which Markham v. Jaudon was based.

We claimed in the Court below that the New York theory should not be applied to this case, because;

(1) the transaction was in Massachusetts;
(2) the insolvent had pledged respondent's stocks on general loan with their consent; and
(3) the New York theory is unsound, and not being binding on a national Court in respect of a transaction, which did not arise in New York, could be examined as an original question.

In the two stock cases which have come into this Court, the one from New York, and the other from Illinois (whose law agrees with that of New York), this Court had no occasion to pass upon it and it is an open question in the national tribunals.

Clews v. Jamieson, 182 U. S., 461.
Gallegher v. Jones, 129 *id.*, 193.

Unfortunately for us, the learned Court was so impressed with the undesirability of overturning Markham v. Jaudon at this late day, that it quite forgot that our attack upon it was a secondary matter and ignored our main point.

Granted that it is too late in the day to reconsider the New York doctrine. Granted that it is

not too late to overthrow that of Massachusetts. (equally old, by the way, and more in consonance with the English view, it seems). Granted that the New York view is sound, and the Massachusetts unsound. Granted that the question—whether the Court below erred in applying to this particular controversy the one rather than the other—is not of sufficient general importance to warrant this application.

There yet remains a question, which was not considered below, which is vital, and which we submit is of such far-reaching consequence in the administration of the Bankrupt Law, as to deserve the attention of this Court.

May a stock broker, who, with the consent of the customers has pledged their stocks on general loan and by reason of his insolvency is unable to carry out his respective obligations to deliver to respective customers their respective stocks on demand, prefer one of them at the expense of the others?

In short, are such customers under such circumstances, his creditors or his debtors?

The First Circuit holds that they are creditors, the second that they are debtors, and we ask this Court to say which is right.

Although the mandate has been signed, the record is still in the Circuit Court of Appeals, and the writ may be directed to that Court.

The Conqueror, 166 U. S., 110.

We submit that the petition should be granted,

JOHN BROOKS LEAVITT,
Of Counsel.

October Term, 1906.

George F. Ebert, Law Printer, 22 Ann Street, New York.

Office Supreme Court U. S.
FILED
OCT 3 1906
JAMES H. MCKINNEY,
Clerk

Supreme Court of the United States.

HENRY ARNOLD RICHARDSON, as Trustee in Bankruptcy of J. Francis Brown,
Petitioner,

vs.

JOHN M. SHAW and Alexander Davidson,
Respondents.

No. [redacted]122

Please take notice that a petition, of which a copy is annexed, will be presented to the Supreme Court of the United States at the Capitol in the City of Washington, D. C., on the second Monday of October, at the opening of the Court, and a motion then made for a writ of certiorari as prayed for therein.

Dated September 15th, 1906.

Yours, etc.,
JOHN BROOKS LEAVITT,
Attorney for Petitioner.

To Messrs.
Campbell & La Far,
Attorneys for Respondents.

SUPREME COURT OF THE UNITED STATES.

HENRY ARNOLD RICHARDSON, as Trustee in Bankruptcy of J. Francis Brown,
Petitioner,

vs.

JOHN M. SHAW and Alexander Davidson,
Respondents.

To the Supreme Court of the United States:

The petition of the above named petitioner respectfully shows to this honorable Court, as follows:

I. That your petitioner is the plaintiff, and the above named respondents are defendants, in a certain action in the District Court of the United States for the Southern District of New York, which action was begun by him as trustee in bankruptcy of one J. Francis Brown, a stock broker in Boston, to recover a preference under Section 60 of the Bankrupt Act, and such action involves a conflict between the law of the State of Massachusetts and that of New York concerning the relation of customer and broker in respect of stocks carried "on margin," and has resulted in a conflict of decision between the Circuit Courts of Appeal in the First and Second Circuits.

II. The facts which present such questions, are as follows:

(1) On June 27, 1903, said Brown, who had been carrying various stocks on margin for various customers under identical conditions, and had been insolvent for some two months, failed, and in the following October was duly adjudged a bankrupt by the United States District Court of Massachusetts, and your petitioner was thereafter duly elected as Trustee in Bankruptcy, duly qualified as such, entered upon the discharge of his duties, and discovered a transfer of property by said Brown to the respondents, the effect of which transfer would be to enable the respondents to obtain a greater precentage of their claim against the bankrupt than any other of his customers, whose relations to him were in all respect identical with theirs.

(2) In the preceding February, the respondents, who are co-partners in the City of New York, with a branch office in Boston, had opened a speculative account "on margin" with said Brown for purchase and sale of various securities by him as their broker, which transactions were conducted by their agent in Boston, the account being carried on Brown's books in their agent's name, and their margin consisting from time to time of securities as well as cash.

(3) On June 24th of that year the respondents had a margin to their credit of about 20 per cent., which in accordance with custom they were entitled to reduce to ten per cent. by demanding payments on account, and their agent having learned of Brown's insolvency demanded and received from

him a cash payment of $5,000, and on June 25th, demanded all the securities, carried on their account or deposited to secure the same.

(4) Under the law of Massachusetts, where the transactions occurred, which law was proved as a fact upon the trial, the relation of broker and customer in respect of stocks "carried on margin" by the one for the other, is that of parties to an executory contract, whereby the customer, not yet the owner of the stocks, may become so, on demand and tender, and the broker is under obligation to deliver them at a price certain (*i. e.*, the price at which they were bought, plus commissions). Under the law of New York, where the action was tried, and which law was adopted by the Courts below, the relation is that of parties to an executed contract, whereby the customer becomes the owner at the time of the purchase by the broker, and their subsequent relations are those of pledgor and pledgee.

Under the *lex fori*, the broker's pledge of the stocks on his general loans without the consent of his customer is a conversion. Under the *lex loci*, the broker has the right thus to pledge the stocks, for they do not belong to the customer.

Under the *lex fori*, the broker is the creditor of the customer for a balance due on the purchase price, whereas under the *lex loci* the broker is the debtor of the customer, being under obligations of a three fold nature, for the margin paid, for the delivery of the stock, for damages in case of failure to deliver.

Under the *lex fori*, if the customer does not get his stocks on demand and tender, he has a provable claim in bankruptcy in tort as for conversion, but

under the *lex loci* he has a provable claim on contract without any demand at all. Thus under the law of Massachusetts, on June 24, the insolvent was a debtor to his various customers, including respondents.

(5) In addition to his right by law of his State to pledge such stocks on general loans Brown had made the right the subject of special contract with his customers, including respondents, and pursuant to his right by law and by contract, had in fact pledged the securities in question and those carried for other customers on general loans, and his payment of the $5,000 on June 24, and transfer of other assets on June 26, as hereinafter set forth, for the purpose of enabling him to comply with the demand hereinbefore mentioned, necessarily prevented him, being insolvent, from meeting similar obligations to other customers.

(6) The securities, carried by Brown in respondents' account and deposited to secure the same, were at the time in pledge on general loans to three pledgees, two banks and a banking firm, Brown, Riley & Co. With the latter the insolvent had a margin of credit of about $10,000, and with their aid he assembled in their hands all of such securities. An accounting was had between him and respondents and resulted in the following figures:

Securities of respondents		$45,583.75
Margin of	"	10,664.13
Payable by	"	$34,919.62

The insolvent increased his margin with Brown, Riley & Co. by his check for $1,200, and endors-

ing to them a debtor's note for $5,000, and they agreed to deliver up the securities on receiving $34,919.62. This was done on June 26th, the securities being delivered to one Gale, president of a trust company, who gave the company's check for that amount, to the order of Brown, Riley & Co.

In legal effect, as your petitioner conceives, the insolvent orally assigned to the respondents so much of his own margin with Brown Riley & Co. as represented the amount of respondents' margin with him, to wit, $10,664.13, and they obtained the securities for $45,583.75 by paying to the pledgees the difference, to wit, $34,919.62. Had they not received the $5,000, they would have had to pay only $29,919.62 to get the stocks.

(7) Thus the insolvent transferred to the respondents, they knowing of his insolvency, $5,000 in cash and $10,664.13 in other assets (either as his interest in the securities themselves, or as his margin with his pledgees), and they were made whole, at the expense of his other customers, to whom he was under similar obligations.

III. Believing this to be a preference forbidden by the Bankrupt Law, your petitioner began the aforementioned suit to recover such $15,664.13, the action was tried before Mr. Justice Holt and a jury in the City of New York, the learned Judge adopted the law of New York rather than that of Massachusetts, held that the respondents were not creditors of the bankrupt, directed a verdict against your petitioner, judgment was entered thereon, your petitioner sued out a writ of error in the Circuit Court of Appeals for the Second Circuit, and after

argument, that Court affirmed the judgment, and granted a mandate remitting the cause to the said District Court for judgment accordingly, but said mandate has not yet been executed, and the record is still in the Circuit Court of Appeals.

IV. Your petitioner urged upon the said Appellate Court that the fact that the insolvent had pledged the securities on his general loans with the consent of the respondents, operated to make the difference between the Massachustts and New York theories immaterial, for the reason that upon making such a pledge, the broker necessarily becomes obligated to secure the customer against its consequences, and should to that extent at least be considered as a debtor; that under such circumstances, no customer could obtain from the pledgee securities carried on his account on tender merely of the balance due by him to the broker, without the aid of a court of equity, in an action to which the broker and all other customers in like case must be parties; that a court of equity would apply the rule, equality is equity, and an insolvent must, under the Bankrupt Law, during the four months act on the same principle; and furthermore your petitioner contended; if this were not so, that the *lex loci*, should be applied rather than the law of New York.

The learned Appellate Court entirely ignored these contentions in its opinion.

Your petitioner also contended that the law of New York was unsound, had involved its Courts in numerous contradictions, and could not be applied to transactions like that at bar without destroying one of the fundamental principles of the Bankrupt Law, and putting stock brokers in a

favored class, seing that an insolvent broker could please one of his customers and be discharged from all obligations to the others.

The learned Court held that it was too late to upset the New York theory, right or wrong, that under it the respondents were debtors to, and not creditors of, the insolvent, and hence there was no preference within the meaning of the Act. In so deciding said learned Court is in direct conflict with the Circuit Court of Appeals for the First Circuit, which, in Swift's case (112 Fed. Rep., 319), held that a Massachusetts broker carrying stocks on margin is a debtor of his customer, and that the latter has a provable claim in bankruptcy, even in the absence of any demand upon the broker for the delivery of the stocks thus carried.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of this Court, directed to the Circuit Court of Appeals for the Second Circuit, to the end that said record, together with all proceedings in the said Circuit Court of Appeals, may be brought before this Court for such review as may be deemed proper.

And your petitioner will ever pray.

HENRY ARNOLD RICHARDSON.
Petitioner.

JOHN BROOKS LEAVITT,
Of Counsel.

Eastern District of Massachusetts, ss.:

Henry Arnold Richardson, being duly sworn, says that he is the petitioner named in the foregoing petition, and that the said petition is true of his own knowledge, information and belief.

HENRY ARNOLD RICHARDSON.

Sworn to before me this 17th day of September, 1906.

Clarence R. Neal,
Notary Public,

[SEAL.]

Stillman Appellate Printing Co., 6 Park Place, N. Y.

Office Supreme Court U. S.
FILED
OCT 9 1906

Supreme Court of the United States.

HENRY ARNOLD RICHARDSON, as Trustee in Bankruptcy of J. FRANCIS BROWN, bankrupt,
Petitioner,

against

JOHN M. SHAW and ALEXANDER DAVIDSON,
Respondents.

No. [redacted] 12[redacted]

Respondent's Brief.

Petition for a writ of certiorari to review a judgment of the United States Circuit Court of Appeals for the Second Circuit, affirming a judgment of the United States District Court for the Southern District of New York in favor of the respondents, entered upon a verdict directed by the Court. The decision of the Circuit Court of Appeals was handed down in June, 1906, and has not yet been reported.

The petitioner, trustee in bankruptcy of a stock broker carrying on business in Boston, Mass., brought an action at law to recover the amount of an alleged preference.

POINTS.

I.

No sufficient reason is suggested for granting the writ.

(*1*). There is no conflict between the decision made by the Circuit Court of Appeals in the instant case, and the decision in the First Circuit in

In re Swift, 112 Fed. Rep. 315.

In the latter case it was held, that the customer had a provable claim against the broker, because the intervention of bankruptcy before performance of the contract had made it impossible for the broker to perform. In the case at bar the contract was performed before bankruptcy.

(*2*). While it is true that the courts of New York and of Massachusetts take divergent views of the relations and legal rights of parties to a speculative contract, nevertheless the subject is of merely academic interest here, because even under the law as understood and applied in Massachusetts there was no preference given the respondents.

The point of the decision in

Weston v. Jordan, 158 Mass. 401,

was that there the broker had entirely failed to perform his part of the contract. He had neglected to keep under his control any of the kind of stock bought by his customer, so that when the customer tendered the balance of the purchase price, he then (being insolvent, as the customer knew) went into the market and bought shares to fulfill his contract and satisfy the customer's claim, the price of the

stock then exceeding the sum paid to the broker therefor. This was a new transaction. It was exactly like satisfying any other debt arising from a breached contract.

The argument that the bankrupt in the present case had equally with the broker in the case cited parted with or put out of his control, by pledging in general loans, the stocks carried for the respondents, ignores the right, recognized in Massachusetts as everywhere else, of the broker to pledge his customers' stocks *en bloc* for his own purposes.

Brown, the broker, redeemed from his pledgees stock he was carrying for the respondents. The stocks were under his control, and he had violated no obligation by the use he had made of them. Upon no theory of the law anywhere recognized did the transaction of June 26, 1903, constitute a preference.

(3). The case is governed not by the law of Massachusetts, where the contract was made, but by the common law, as understood and applied in the Federal Courts. In other words, the question is one of general law and not of local law. The question here does not, as did the questions before this Court in *Thompson v. Fairbanks, 196 U. S. 516,* and *Humphrey v. Tatman, 198 U. S. 91,* concern the validity of the contract underlying the transaction assailed as a preference. The crux of the contention in each of the cases cited was the validity of a mortgage affecting after-acquired property. The local courts in Vermont and Massachusetts holding such mortgages valid, the Supreme Court accepted that view. But in the present case there is no such question. The transactions between the parties are conceded to have been valid, and the question arises, what relations did they create?

(4). The principle, thoroughly established in New York, and to some extent accepted elsewhere, that the relation of stock-broker and customer in a speculative transaction is that of pledgor and pledgee, the customer being the general owner of the stocks purchased, and the broker the pledgee thereof, as security for his advances, is, we submit, more consonant with the intention of the parties than the view adopted in Massachusetts.

1 Dos Passos on Stockbrokers (2nd ed.), pp. 179-200.

For the rule in New York see

Markham v. Jaudon, 41 N. Y. 235.
Stewart v. Drake, 46 N. Y. 449.
Stenton v. Jerome, 54 N. Y. 480.
Baker v. Drake, 53 N. Y. 211; 66 N. Y. 518.
Gruman v. Smith, 81 N. Y. 25.
Capron v. Thompson, 86 N. Y. 418.
Caswell v. Putnam, 120 N. Y. 154.
Gillett v. Whiting, 120 N. Y. 402; 141 N. Y. 73.
Minor v. Beveridge, 141 N. Y. 399.
Hurd v. Taylor, 181 N. Y. 231.
Content v. Banner, 184 N. Y. 121.
Douglas v. Carpenter, 17 App. Div. 329.

The same principle has been more or less clearly adopted in other States:

Child v. Hugg, 41 Cal. 519.
Thompson v. Toland, 48 Cal. 99.
Cashman v. Root, 89 Cal. 373.
Skiff v. Stoddard, 63 Conn. 198.
Brewster v. Van Liew, 119 Ill. 554.
Maryland Life Ins. Co. v. Dalrymple, 25 Md. 242.
Baltimore Ins. Co. v. Dalrymple, 25 Md. 269.

Gilpin v. Howell, 5 Penn. St. 41.
Wynkoop v. Seal, 64 Penn. St. 361.
Esser v. Linderman, 71 Penn. St. 76.

The Supreme Judicial Court of Massachusetts is quite alone in the view it takes of such a contract and the relations thereby created. No support for the Massachusetts view is found in England.

In

Bentinck v. London Joint Stock Bank, 2 Ch. Div. (1893), 120,

it was proved that by means of what is known as the "contango" system on the London Stock Exchange, the broker is regarded not as the mortgagee or pledgee of the shares, but as the outright owner.

It will be observed from the judgment delivered, that the Court did not determine that the customs of the Stock Exchange established the relation between customer and broker of parties to an executory contract instead of that of pledgor and pledgee, but merely that the Court found a custom already established on the Exchange, which made the relations those of parties to an executory contract. On the other hand, in the United States the Courts have deduced the legal relations from the customs, and, except in Massachusetts, have declared those relations to be those of pledgor and pledgee.

Some of the difficulties of the Massachusetts doctrine are illustrated in

Chase v. Boston, 180 Mass. 458.
Rice v. Winslow, 180 Mass. 500.

In the former it was held, that the broker must pay the municipal tax upon the value of the stocks carried by him for customers on margin; and in the latter it was held, in order to avoid the condemna-

tion of the gaming statute, that the relation of the broker to the customer is that of agent. Precisely how that ruling can be reconciled with the Massachusetts doctrine is not clear, for an executory contract for the purchase and sale of stocks can scarcely create the relation of principal and agent between the customer who orders the stocks bought and agrees to pay for them, and the broker who agrees to buy the stocks and deliver them on demand, or sell them at the customer's order; the title being at all times in the broker.

(5). If J. Francis Brown had refused to comply with the demand of the respondents for the delivery of the stocks on tender of the balance due him *(Weston v. Jordan, 168 Mass. 401)*, or if he had become bankrupt before demand made, thus making performance on his part impossible *(In re Swift, 112 Fed. Rep. 315)*, the respondents would have had a provable claim against him. Neither of these things happened. Brown performed his contract before bankruptcy. The utmost that can be claimed is that he delivered, on receipt of the balance of the purchase price, stocks worth more in the market than the sum received plus the amount of margin already in his hands. Such a transaction has never been held a preference.

It is not every advantage obtained even by a creditor that constitutes a preference, as was illustrated by this Court in

New York County Nat. Bank v. Massey, 192 U. S. 138.

(6). The withdrawal by the respondents of $5,000 of their margin on June 24, 1903, was not a preference.

The agreement between the parties was that the respondents should maintain a margin of ten per

cent. On June 24, when they withdrew $5,000, their margin was about 33-1/3 per cent. *(Record, pp. 30, 33, 34).* By the withdrawal of the margin they increased their indebtedness to the bankrupt, and when they closed their account two days later, they were obliged to pay precisely $5,000 more to gain possession of their stocks than they would have had to pay if the margin had been maintained without diminution.

The $5,000 withdrawn from the broker, being a sum in excess of the agreed margin, was not a debt owing by the broker to the respondents. Payment of that sum therefore was not the payment of a debt. On the contrary, as has already been pointed out, it was the respondents who were indebted to the broker. As security for their indebtedness the broker held the stocks purchased for the respondents. When the latter withdrew $5,000 of their margin, they simply exercised one of their rights under the agreement, which was that the margin should equal ten per cent of the market price of the stocks, from time to time, according to their fluctuations. At the time of the withdrawal, the margin was more than three times the agreed percentage. While the respondents by the withdrawal increased their indebtedness to the broker, his estate was not depleted, because the stocks in his hands were adequate security for the difference between the purchase price and the amount of margin remaining.

The withdrawal of $5,000 on June 24, 1903, and the closing of the account on June 26, were essentially one transaction.

CONCLUSION.

It is respectfully submitted that the prayer of the petition should be denied.

October Term, 1906.

MAURICE UNTERMYER,
ABRAHAM BENEDICT,
ARTHUR B. LA FAR,
E. S. THEALL,
Of Counsel for Respondents.